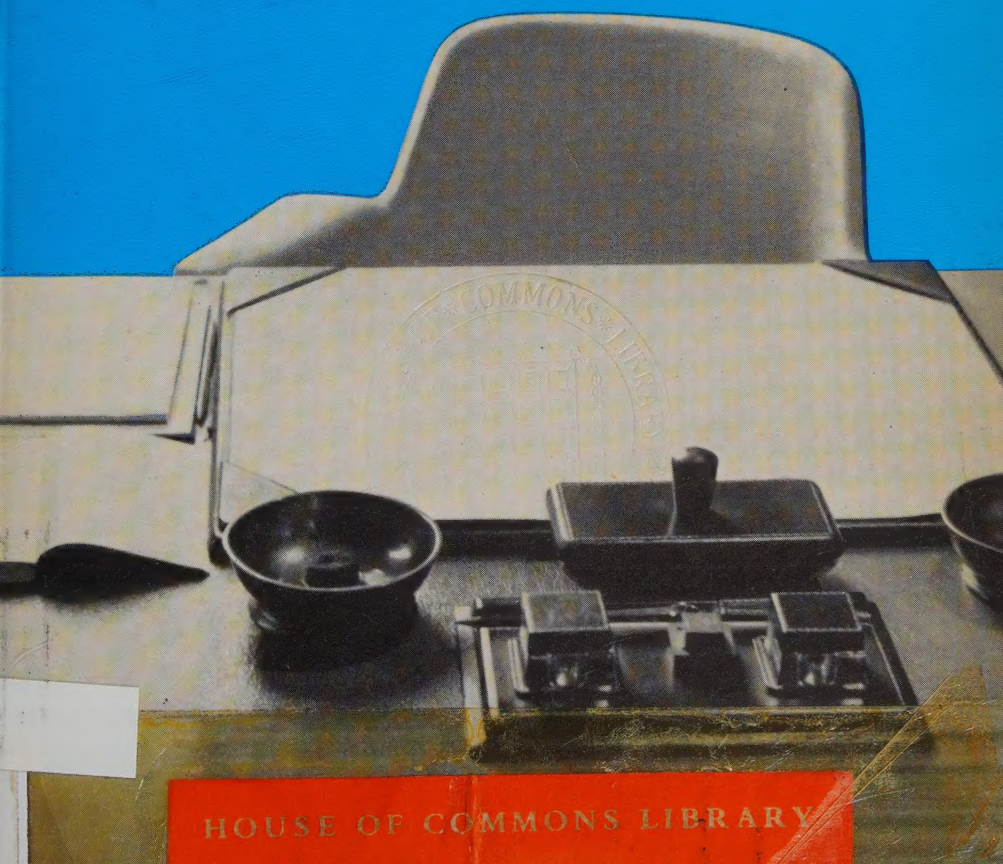


Executive Remuneration in the United Kingdom

A. J. Merrett



HOUSE OF COMMONS LIBRARY



TO BE
DISPOSED
BY
AUTHORITY

LOCATION

R. Capital & Labour

AUTHOR

MERRETT

ACCESSION NUMBER

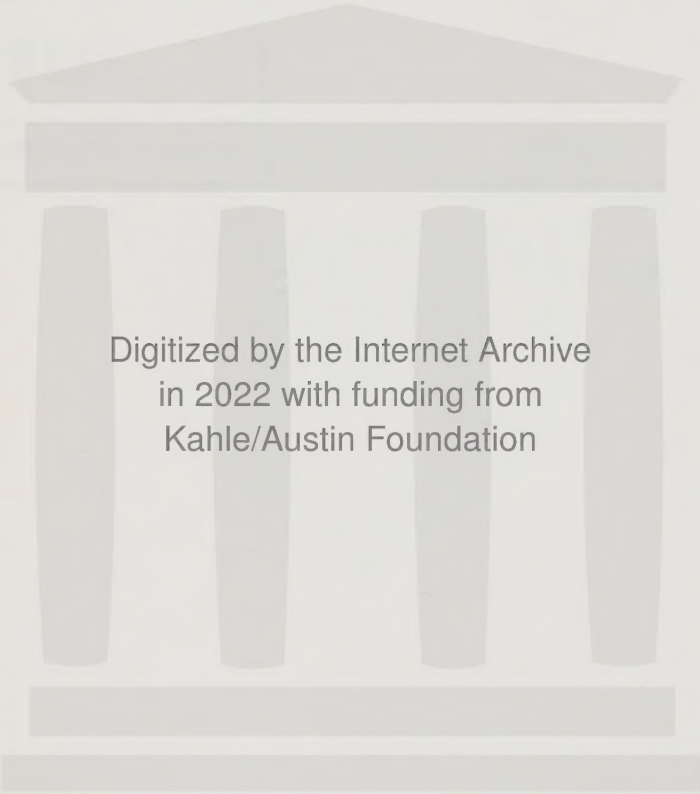
61208

HOUSE OF COMMONS LIBRARY

House of Commons Library



54056000546496



Digitized by the Internet Archive
in 2022 with funding from
Kahle/Austin Foundation

Executive remuneration in the UK

Other published work

Business economics and statistics

A. J. Merrett with G. Bannock; London, Hutchinson, 1962

The finance and analysis of capital projects

A. J. Merrett and Allen Sykes; London, Longmans, 1963

Housing finance and development

An analysis and programme for reform

A. J. Merrett and Allen Sykes; London, Longmans, 1965

Capital budgeting and company finance

A. J. Merrett and Allen Sykes; London, Longmans, 1966

Executive remuneration in the UK

A. J. MERRETT



LONGMANS

LONGMANS, GREEN AND CO LTD

48 Grosvenor Street, London W.1

*Associated companies, branches and
representatives throughout the world*

© A. J. Merrett, 1968

First published 1968

*Printed in Great Britain by
The Camelot Press Ltd., London and Southampton*

For Tony and Lorenzo

Contents

Introduction	xi
1 Corporate efficiency and executive remuneration	1
2 Executive remuneration and executive choices	14
3 The method of the survey	29
4 The survey of income, wealth, taxation and hours of work	35
5 Remuneration and management efficiency	45
6 Executive efficiency and remuneration: UK and US	56
7 Implications	64
APPENDICES	
A Questionnaire	71
B Notes and statistics	76

Acknowledgements

The book would not have been possible without the unstinting co-operation of the executives responding in our survey and to them I must extend my appreciation. But the research and fieldwork itself would not have been possible without generous financial support from the Institute of Directors and their cooperation in making available their records of membership and encouraging cooperation of their members. For the Institute's willingness to support this study so generously, while meeting the author's prior condition of complete and unfettered discretion as to publication, I am particularly indebted.

I must also thank Mr G. D. Newbould for his own near monumental labours in organising, directing and collating the results of the survey and for his preparation of Appendix B.

Finally, I must thank my secretary, Miss Susan Fry, for her efficiency and unfailing good humour in preparing and typing untold numbers of untidy drafts.

A.J.M.

London, November 1967

Introduction

This book arose out of an increasing conviction, based on some years of experience as an executive in industry and as a consultant to industry and government, of the critical importance in large organisations of the quality and effective utilisation of management. In a larger context there is evidence for the view that the size, quality and utilisation of a nation's educated labour force has been a decisive influence on both the political and economic history of this century. Examples of this are the remarkable success of Germany in the exploitation of its educated labour force, for both military and economic purposes, and the outstanding success of the United States in utilising its educated labour force in industry and the space programme.

In contrast the United Kingdom appears to have been markedly inefficient in the deployment and utilisation of this section of the labour force for either military or economic advantage, save under the extreme duress of wartime necessity. In particular, there appears to have been a relatively low proportion of the exceptionally gifted recruited to the career of management, and a generally low level of effective utilisation of such management talent as has been recruited.

To a large extent, given the inadequacy of detailed evidence, this must be a matter of opinion, although the extensive comparison of UK and US executives in Chapter 6 certainly suggests significant differences in executive efficiency, particularly in the ranks of middle management. It is possible that these inadequacies are the result of a failure to use financial incentives to raise the quality of individual recruited to the career of management, and a further failure to use remuneration to obtain the most effective utilisation of the individuals who were recruited. In sum the hypothesis is that the apparent inadequacies were due to a failure to utilise the pricing system (rates of remuneration offered) to exploit most fully the potential for corporate efficiency arising from executive abilities.

The function of the price mechanism is to attract resources to the activities in which they will be most beneficially utilised and most efficiently exploited. Regarding executive remuneration as simply a price paid for a basic factor of production, it is apparent that the price mechanism for this factor of production is subject to massive intervention and, therefore, possibly impaired by heavy taxation weakening its effectiveness in allocating and exploiting actual and potential executive abilities. In other words, it is possible that net remuneration in the UK is inadequate to attract a sufficiently high standard of abilities into management, and also inadequate to induce efficient exploitation of such talent as has been attracted to the career.

Public debate on the question of executive remuneration and taxation has tended to ignore completely the first problem, namely that of the importance of net remuneration in allocating the educated labour force to those employments in which its economic contribution will be greatest. It is part of the thesis of this book that there are in fact extremely powerful institutional forces in the UK which bias the educated labour force away from managerial employment. If this is the case then to ignore the question of the allocation of the educated labour force may be to ignore a fundamental aspect of the problem.

Even in the context of individuals already involved in the career of management, the discussion appears to revolve round whether or not the individual in question would or would not 'work harder' if his net remuneration was greater because of lower taxes. This is a misconceived basis for discussion for two reasons. First, because the issue is not necessarily whether an executive will 'work harder', but whether it would be possible to induce him to work more *effectively* with re-orientation of his efforts away from gratifying his professional or functional interests and towards profit-increasing effort.

Secondly, the discussion seems basically ill-founded since it proceeds on the basis of what the executive's reaction might be to higher net remuneration in the context of his own private inclination—whether he would *volunteer* to work more effectively. But a company's standard of management efficiency is not set by the private inclination of executives. It is set by the company itself responding to the need to remain competitive against other companies with higher standards of corporate efficiency, possibly stemming from more effective use of remuneration to attract a higher quality of managers and to utilise them more effectively. Thus the substantive question is not what existing managers would volunteer but (1) what standard of individual might be attracted

to the career of management, (2) what standard of corporate efficiency would the company be induced to *impose*, and (3) what level of management efficiency (and management discipline) could managers be persuaded to *accept*, given higher levels of net remuneration?

This question leads into the fundamental problem of ways in which executive efficiency affects the efficiency of the modern corporation.

The modern corporation is a highly complex economic machine which, given its particular characteristics of size, function and complexity, has its own economic method of operation in the same way as, say, an airliner has its economic method of operation in terms of speed, payload and distance. In the same way that the economic logic of the airliner requires certain standards of performance from the air crew, the modern corporation, for its efficient working may need to impose special standards of performance on its executives. These may be quite different from the standards which economic logic imposes on other occupations—for example, manual workers. A partial explanation of the remarkable phenomenon of American executives working fifty-seven to sixty hours per week while American manual workers work forty hours per week is almost certainly the different requirements for economic efficiency of the two occupations. Thus the indivisible nature of many executive roles (that is the superior efficiency which results from concentration rather than delegation, particularly where co-ordinative roles are involved) necessitates great personal involvement, longer hours and the strain of an erratic and highly peaked work load.

The airliner analogy may serve to illustrate another important characteristic of the executive role and executive remuneration. Where large amounts of economic resources are involved and where the inadequacy of some individuals may involve hardship or risks to many others, it is essential that an exacting standard of discipline is imposed on those in charge of these economic resources. In the case of air crew (where both these conditions obtain) the standard of discipline and the level of operating performance is extremely exacting. Moreover, in the nature of this occupation legalistic standards of proof of inadequacy—i.e. proof beyond reasonable doubt—often could not be obtained without quite unacceptable economic and human risks. Hence, disciplinary decisions on demotion or dismissal must often be taken on the basis of a relatively slight balance of probabilities which would be regarded as unjust by the standards of private life.

It is arguable that the efficient economic operation of the modern corporation requires exacting standards of performance and discipline

for essentially similar reasons, namely that the executives in question are responsible for the efficient utilisation of vast economic resources and indirectly responsible for the economic welfare of the other employees.

There is undoubtedly in management, as in any other profession, a proportion of individuals who, *having entered* their particular profession, will, through natural vocation, fully meet the highest standards of efficiency and discipline which that profession requires with relatively slight concern for financial advantage. But no profession which accounts for some 37 per cent of the educated labour force can rely for its effectiveness on the hazard of the individual's selection of career and the hope of vocational motivation.

Business is therefore a major profession and one which may lack, for many of the individuals it needs to recruit, the vocational attractiveness of other professions. It may also require standards of efficiency and discipline which are far from universally acceptable and even contrary to the basic trends of modern societies towards greater leisure and vocationally enjoyable employment. The role of the *pricing* system in this situation is to override these trends and cause a sufficiently high proportion of the educated labour force—and particularly those with the basic abilities that would fit them for possibly more vocationally enjoyable employment—to accept what would otherwise be unacceptable.

It is in this general context that the theory of executive remuneration and corporate efficiency is developed in the following chapters.

Corporate efficiency and executive remuneration

All discussion of the impact of executive remuneration on corporate efficiency implies some theory as to the connection between remuneration and efficiency. The theory must in essence be a theory of human motivation. Such motivation is complex even in relatively simple situations. It must, therefore, be expected that in this context, in which we are considering career choices and—through the level of management effort which the individual makes—the fundamental balance between work and leisure, the motivational theory may be complex. Moreover the effect of such motivation must depend on the methods of management organisation and the structural problems of sustaining any given level of efficiency in the modern corporation. It must, for example, depend on the extent to which the company devolves profit responsibility and the complex of forces inhibiting efficiency in the large modern corporation.

In this chapter we put forward an explicit theory of the underlying factors relating executive remuneration to corporate efficiency in the present-day corporate environment. It should be stressed at the outset that in this context we are defining efficiency as the net contribution which the executive makes to the company's *profitability*. This may be quite distinct from hours of work, or the energetic involvement of the executive in work which contributes relatively little to profitability, either because it is inefficiently performed or because it is basically directed towards fulfilment of the executive's personal enjoyment from participating in particular activities.

Given that human beings cannot be subjected to laboratory tests over long periods, it is inevitable that any theory of human motivation must be difficult to prove. In an issue of the complexity of executive motivation in the context of the corporate environment, we can at best infer motivation from behaviour. The two methods by which evidence for alternative theories of motivation could usefully be obtained would

2 Executive remuneration in the UK

be first in the context of companies practising very substantially different methods of management remuneration and, secondly, in the context of companies *in countries* between which the relative forms of management remuneration differ substantially. The intercountry comparison is of wider scope than the intercompany since it may be that the long-term effects of differences in management remuneration (and in relative remuneration of management compared with other professions) in different countries is to produce a basic change in the cultural environment as it effects management efficiency.

In the light of these considerations we attempt, in the penultimate chapter of this book, to relate our theory of executive efficiency to the available evidence on UK and US executives.

The place of non-financial remuneration

The theory we are trying to establish is one which would enable companies and governments to predict the impact of changes in executive financial remuneration on executive efficiency. But before developing this it is useful to comment briefly on the place of non-financial remuneration in executive motivation.

The potential of non-financial motivation is not to be denied or minimised. There is undoubtedly a great need for a theory of the non-financial motivation of executives and its relation to corporate efficiency, in order that this motivation may be harnessed to produce greater corporate efficiency. By implication theories already exist in this regard. For example, the extensive use in the UK in recent years of honours and awards for service on government committees, exporting, etc., implies that some executives are substantially motivated by a desire to obtain honours and awards, and that through the honours system this motivation can be harnessed to government and public service. There exists within many companies a not dissimilar form of non-financial remuneration, in the implied honour that goes with the occupation of posts of different status.

It is, however, inherent in the character of the corporate environment and the general difficulty of sustaining relatively high levels of efficiency that, in the existing state of knowledge, the scope for achieving relatively high corporate efficiency by non-financial motivation is extremely limited. In the context of relatively enclosed professional bodies—such as the Civil Service or the army—it is perhaps possible to motivate individuals to a substantial degree by the promised differences in status unaccompanied by corresponding differences in remuneration. But in

so far as this is possible it relies largely on the fact that members of these professional bodies primarily relate status to other members in their professional body and not to the value of this status in the outside world.

The actual working units of companies are relatively small (even where the company itself is on aggregate very large) and the activity of management is primarily operational rather than primarily advisory (as in the Civil Service). Given these characteristics, motivation by differences in status (unaccompanied by corresponding differences in remuneration) are likely to be much less effective than in the Civil Service, (a) because the reality of actual power is more obvious in an operational context (that is the number of staff the executive actually has and the powers of decision which he has are more obvious than in an advisory role, as in government service), and (b) in the executive's more extensive contact with the outside world, company titles are relatively unimportant and the major mark of status is relative remuneration as exemplified by the manner in which the executive lives. Thus in the context of executive motivation only limited advantage can be expected from the employment of incentives rising from status unaccompanied by corresponding differences in remuneration.

Executive motivation and the control of the modern corporation

The fundamental problem of modern management is the control of profitability in large companies, given that such companies are under modern conditions, subject to extremely powerful forces whose ultimate effect is towards the disintegration of central control over corporate profitability, with the result that the company becomes (or remains) a largely uncontrolled and inefficient confederation of conflicting power blocks and functional interests. Two distinct sets of forces are operating in this direction. The first is the increasing size of the company in terms of net assets and geographical dispersion. Thus the three hundred largest UK companies are increasing (in terms of net assets) by 7 per cent per annum in real terms (that is after allowing for increases in the price level). The increasing number of subsidiaries, their relative size, and the increasing number of overseas operations, are among the forces which are tending to stretch the span of central control over profitability to the point of increasing ineffectiveness.

The second set of forces, working in essentially the same direction but different in character, lies in the ever-increasing *functional* complexity of business, both in terms of technology and management

operations. With the increasing complexity of technology those responsible for central control over profitability are inevitably, to a significant degree, forced to rely on the largely unproven claims and possibilities of research and development executives. They themselves will rarely have the detailed knowledge or experience which would enable them to judge the activities directly. Such companies are for example subject to the hazards of large sums being mal-utilised, if not wholly wasted, in the pursuit of inefficient or irresponsible research gratifying more the intellectual curiosity of the executives than the profitability of the company. Similarly with the increasing complexity of, say, major marketing strategy, central management must rely more and more on the immediately unproven views and judgment of the marketing executive, and is therefore more and more subject to the hazards of inefficiency from marketing activities directed to obtaining volume rather than profitability.

These changes in the basic features of management have led to the widespread adoption in the UK (largely following the American example) of the practice of attempting to give individual managers a defined profit responsibility by reorganising the company into profit or cost centres subject to detailed accountability and budgeting. This system is essentially one of controlled decentralisation in which the span of the control of the centre is confined (1) to policy, (2) to setting standards of efficiency (through the budgeting, planning and reporting processes), and (3) the motivation of management (through incentives and disciplinary action) to achieve these standards.

The literature describing this method of control is extensive¹ and an understanding of these and related systems of control is fundamental to any understanding of the relationship between management remuneration and corporate efficiency. The essential features of this system of management control are shown in Figure 1.1. The basic functions reserved for top management are indicated by the top three boxes and are the three functions referred to earlier. The general objectives set by top management are processed through planning and budgets (the lower lefthand box) into detailed operational plans which are then put into effect (as indicated by the middle lower box). Throughout this process there is a two-way flow of information as between the planning

¹ See for example Robert M. Anthony, John Dearden and Richard F. Vansell, *Management Control Systems*, Richard D. Irwin, 1965, in particular the description of control system of General Electric in the article by Ralph J. Cordiner, that of Fords in the article by E. B. Rickard and that of Du Pont by William Travers Jerome.

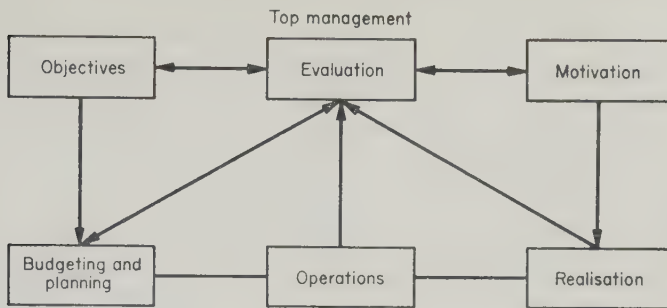


Figure 1.1

and budgeting operations and the top management concerned with setting and evaluating standards. Similarly, as these plans and budgets are progressed to the point of operation there is normally fairly continuous monitoring of actual operations in order to determine the extent to which they conform to budgets and plans. This is indicated by the arrow connecting the box marked 'Operations' to that marked 'Evaluation'.

The outcome of this process is the righthand box marked 'Realisation'. In order, however, to realise a high standard of efficiency, top management must be involved in a continuing process of setting and evaluating objectives and standards of efficiency and motivating management to realise them. In part the detailed process of budgeting is designed constantly to apprise top management of the performance of executives in order that top management may be in a position to apply appropriate motivation. *It is essentially this motivation of management which, as shown in Figure 1.1, closes the loop of control connecting objectives at one extreme with realisation at the other.* Without this ability to motivate management the loop of control is broken and much of the whole system of control rendered ineffective. There will be the *formality* of the setting of objectives, their development through plans and budgets, detailed reporting and evaluation, but ultimately if the objectives are not being realised and top management cannot motivate managers to effect realisation, the system degenerates into an expensive form of planning the impossible and commenting on the unsatisfactory.

The seriousness of such a break in the loop of control must be seen in the context of the extremely powerful forces referred to above, which are making for the disintegration of control and the economic breakdown of the large corporation. With such a breakdown of the

system of control, the large corporation may—and frequently does—become a largely unregulated economic machine with great potentiality for damage to the economy (through failure of the company to make efficient economic progress) and similar potential for infliction of personal hardship on its employees (through the disruption of their careers and employment).

Top management's control over executive motivation is therefore fundamentally important in the context of this control system which has been or is now being established, in its variant forms, in the majority of modern companies. A company possesses two major powers of motivation. The first might be described as organisational motivation. This comprises the various forms of organisation, such as defined individual responsibility, detailed reporting and assessment, competitive comparisons of performance, which may be used to motivate the executive towards fulfilling a high standard of efficiency.

The second form of motivation is that of promotion, demotion and dismissal. It is undoubtedly the case that the prospect of more rapid promotion is a substantial factor in executive motivation. As a 'carrot' it is, however, subject to the limitation that it is inherently restricted: the number of opportunities for promotion are limited by the size and organisation of the company. Moreover, there are often a substantial number of executives who have limited capacity for positions of greater seniority because of their lack of one or more of the additional qualities required for more extensive responsibilities. This frequently occurs in the context, for example, of marketing or production executives who are capable of making a substantial contribution to profitability. The company has an evident and important need to motivate these executives by other means than the prospect of promotion to responsibilities for which they are basically unfitted.

Motivation by demotion and dismissal in the UK is probably the least used form of management motivation. The practical limitation on its usefulness is that security is an integral part of the benefit which any employee receives from his employment: it is as fundamental a part of his remuneration as direct financial benefit. For this reason he is generally as little prepared to accept a substantial reduction in security of employment as in financial remuneration relative to that obtainable in other companies. In general this means that executives, like other employees, are not prepared to accept great insecurity (compared to that offered by other companies offering similar salaries) unless this can be compensated for by appropriately higher remuneration. The

use of the threat of dismissal as a form of executive remuneration is therefore inextricably related to the extent to which a company is also prepared to offset the general risk associated with such motivation by higher material reward.

The system of centralised control and individual profit responsibility is itself designed to provide substantial motivation from its own organisation or structure. Genuine decentralisation and individual profit responsibility combined with careful central evaluation of performance does undoubtedly provide considerable motivation through the organisational structure itself. At the same time it creates a need for a higher standard of executive capability and efficiency than existed either in the more centralised or uncontrolled forms of organisational structure which this form of organisation has substantially displaced.

Under the older forms of directly centralised control (perhaps the most conspicuous example was that of the British Transport Commission controlling railways and nationalised road haulage), profit responsibility and major decision making was typically concentrated in relatively few hands. The role of other executives tended to be functional—the carrying out of particular circumscribed operations. Their comprehension and experience of direct profit responsibility was typically extremely small.

The other form of corporate organisation which has tended to be displaced by the method of decentralised control described above, is that of the loosely organised holding company in which managing directors of subsidiaries were permitted very extensive and generally uncontrolled power. The most common form of exercise of these powers was autocratic; this again imposed minimal demands in terms of general profit responsibility and initiative on executives at lower levels than managing director within the subsidiary company.

The move to controlled decentralisation has been an attempt to combine the flexibility of local initiative with the advantages of organised succession and safeguards of central control. The result of this has been (a) a need for a higher level of abilities below board level in order to provide a capacity for carrying substantial profit responsibility, and (b) a need to motivate managers to accept a higher standard of efficiency, and similarly motivated to accept the standard of management discipline required to enforce this efficiency. In sum, the nature of the controlled decentralisation form of organisation requires a higher standard of management capability used in such a way as to motivate managers to accept the more demanding role required by profit responsibility.

Management efficiency and management discipline

A particular aspect of this more diffused form of profit responsibility is its implications for management discipline. An essential aspect of controlled decentralisation is the necessity to pass on to less senior executives a more impelling responsibility for the welfare of employees and shareholders. The effective transmission of such responsibility creates a need for a higher and different standard of management discipline than obtains in either centralised or loosely controlled organisational structures in which profit responsibility is shared by relatively few executives. These wider responsibilities have created the corresponding need to subject more executives to the rigours of management discipline formerly imposed (if imposed at all) on relatively few who had major financial responsibility. But it is inherent in profit responsibility, as in many other forms of substantial responsibility for economic and human affairs, that discipline must be the basis of evidence which is typically inadequate by any legally defined standard of the case being 'beyond reasonable doubt'. The delay, cost and ultimate difficulty of establishing this standard of evidence makes it impractical to base management discipline on the relative certainty which would be required for similar action in private life or a court of law. In this respect substantial management responsibility involves the necessary risk of unfairness of the kind that applies in any situation in which a small balance of probability implies large risks because of the magnitude of the sum at stake.

But from the standpoint of public policy and from the standpoint of more general humanitarian considerations than the feelings of the executive directly involved, a higher standard of management discipline must be seen as justifiable, even at not inconsiderable cost to executives themselves. Senior executives, taking the private and public sectors together, are responsible for utilisation and allocation of the nation's resources. Inadequacy and inefficiency on their part must be expected to be extremely costly in terms of financial resources and frequently also *in terms of insecurity and loss of employment for other employees*. Given that a relatively slight balance of probability indicating managerial inadequacy may imply a very substantial *probable* loss in terms of financial resources and human distress, this must be taken as sufficient to justify remedial discipline, despite the fact that in terms of the standards of private life the decision may be thought of as unjustifiable and inhumane, in that the evidence is not and cannot

be such as to meet the legal criterion of 'beyond reasonable doubt'.

In sum the problem of corporate efficiency is the problem of sustaining a standard of efficiency contrary to the most powerful and fundamental forces within the company and requiring, by the nature of

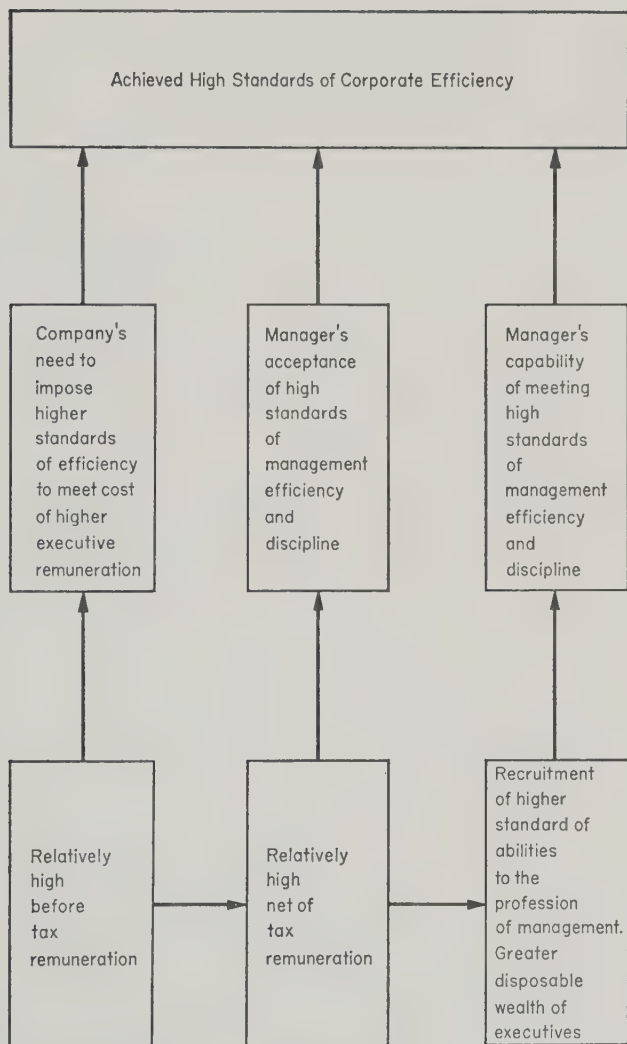


Figure 1.2

modern financial control systems, the widespread application of standards of discipline which in terms of private inclination must be seen as markedly distasteful.

The trimodal theory of executive remuneration and efficiency

In attempting to utilise remuneration as a method of redirecting managerial effort and obtaining acceptance of a higher standard of management discipline, the corporation, implicitly or explicitly, acts collectively, within a framework set by board policy. The policy itself must be influenced by and operate within the framework set by fiscal legislation which may limit or encourage the use of remuneration as a method for attaining these objectives. The relative importance of the fiscal framework within which the company operates will depend on the tax structure and rates of taxation on executive levels of remuneration. The practical extremes range from the absence of any form of taxation on remuneration to the imposition (as in the UK) of maximum rates of tax of $91\frac{1}{4}$ per cent and the attempt to embrace all forms of remuneration within this tax structure. An intermediate case is the United States in which the maximum rate of taxation is 70 per cent while substantial categories of executive remuneration (for example, stock options) are taxed at much lower rates.

Within this framework the relationship between executive remuneration and the standard of executive efficiency, might take the trimodal form illustrated in Figure 1.2. In this theory the cornerstone is the relative *before-tax* remuneration received by executives. By relative is here meant remuneration relative both to other employment in the community (manual workers or civil servants), and to the job environment of the task in question—that is the overall degree of satisfaction obtained from the work having regard to the standards of efficiency and discipline which it involves.

Any standard of before-tax executive remuneration, has an immediate effect on the company simply in the form of its own need, unless profitability is to be allowed to deteriorate, to recoup the costs of executive remuneration by the standard of management efficiency which it seeks to impose. If the company elects to pay relatively high before-tax remuneration it will have a corresponding need to impose higher standards of management efficiency and discipline. This is the first way in which relatively high before-tax remuneration of executives supports the high standards of management efficiency and discipline indicated by the first column and top block of the diagram. The first

column is, therefore, the first mode of our trimodal theory of the relationship between remuneration and corporate efficiency.

A relatively high before-tax remuneration and a sufficiently permissive tax environment, will lead to a relatively high standard of net-of-tax remuneration for executives—as shown by the second box at the lower end of the diagram. Higher standards of relative net-of-tax remuneration should be conducive to executives themselves *accepting* higher standards of management efficiency and correspondingly higher standards of management discipline required to enforce the efficiency. This is the second pillar in the diagram (the second mode) supporting higher standards of management efficiency and discipline.

The hypothesis of this part of the theory is that given sufficiently high net-of-tax remuneration, executives would regard themselves as being compensated for the imposition of higher standards of management efficiency, in particular the redirection of their efforts away from activities which they find congenial or functionally or professionally interesting towards more strictly profit orientated activities.

This acceptance would be of a limited value if it were not accompanied by a rise in the standards of management discipline so that inadequate managers could be discriminated against in terms of salary or promotion or dismissed if this proved to be most conducive to the efficiency of the company. In this context it should be stressed that the problem of management discipline arises primarily as regards managers occupying substantial positions in the company and, typically, from whom the company has received good service in the past.

Thus as a result of changed conditions (e.g. a change in products or processes or a shift from primary stress on marketing to primary stress on cost reduction and development) or simply because of relative deterioration in the individual's own abilities, the need may arise to remove managers from their positions of authority where they may be a serious handicap to the company's future because of their power to block new initiatives or maintain in existence policies or products inimical to efficiency.

Major obstacles to demotion or severance from such individuals are (a) the extent to which the company has, in the eyes of other executives, remunerated them inadequately in terms of their net-of-tax benefits for services rendered, and (b) the extent to which demotion or dismissal involves financial hardship and/or loss of status in the community through their having inadequate financial resources. Both these factors depend on the magnitude of the net-of-tax remuneration which

the executive has received in the past. Hence higher net-of-tax remuneration should reduce the difficulties of imposing higher standards of management discipline. In sum, remuneration which absolved the company from any outstanding obligation to the executive for past services, and which enabled him to provide adequately for the maintenance of accustomed living standards despite the severance, should generally be accepted as a reasonable *quid pro quo* for such higher standards of management discipline.

The final pillar of the trimodal theory of executive remuneration is indicated by the last column of Figure 1.2. This illustrates diagrammatically the proposition that relatively high net-of-tax remuneration should lead to a correspondingly high standard of individual seeking to take up management and this in its turn should lead to executives having the capacity to sustain a high standard of management efficiency and discipline.

The practical context of this in the UK is that of relatively small net-of-tax differentials between the remuneration received by management and that of other professions competing for talent from recruits to the educated labour force (primarily graduates) who replenish the major professions. Thus the modal¹ (most common) before-tax salary in the Civil Service four years after graduation is identical with that of graduates in industry. In the case of the upper echelons of management, the before-tax salaries of directors of the top hundred companies in 1965 was £13,000 compared with £8–9,000 for the thirty most senior posts in the Civil Service. Net-of-tax, however, the differential amounted to around £1,100 per annum.

Our trimodal theory postulates that this would have an adverse effect on corporate efficiency through the *level of ability* recruited to the profession of management compared, say with the net-of-tax differentials in the US between management and other public service professions (see Chapter 6). Whether or not a diversion of the nation's talent from the public sector service industries to the profession of management would be desirable is not a point with which we are here concerned. The point we wish to establish is the manner in which this aspect of relative remuneration can be expected to influence corporate efficiency.

¹ See A. J. Merrett and D. A. G. Monk, *Inflation, Taxation and Executive Remuneration*, Hallam Press, 1967.

Conclusions

This chapter has set out the main elements of the theory connecting executive remuneration both net and gross with corporate efficiency in the context forms of the motivation required for the efficient operation of the modern company.

It was stressed that the size and complexity of the modern corporation requires a broadening of the base of profit responsibility, imposing on a higher proportion of executives a greater degree of profit responsibility, a higher standard of management efficiency and acceptance of a higher level of management discipline.

The main issue to be considered is whether greater corporate efficiency might be brought about by changes in company policy on executive remuneration and in tax legislation. To determine this it was necessary to explore the possible relationship between remuneration of executives and corporate efficiency.

The trimodal theory of the relationship between executive remuneration and corporate efficiency postulated a connection between higher gross remuneration requiring higher standards of corporate efficiency in order to recoup the cost of remuneration, higher standards of net remuneration received by the executive causing him to accept the higher standards of efficiency and discipline and finally the larger net remuneration (relative to other occupations open to the educated labour force), increasing the standard of individual recruited to the career of management.

The evidence for this theory and its implications are the subject of the following chapters.

Executive remuneration and executive choices

The theory and analysis of the previous chapter argued for a three-way relationship connecting management remuneration both gross and net-of-tax with the level of corporate efficiency. The most extreme contrary theory is that which contends that the relation of corporate efficiency to remuneration is solely through gross remuneration, and that net-of-tax remuneration (and hence taxation) itself has no effect on corporate efficiency. This theory is rarely stated explicitly but it is, for example, the essential foundation of the argument that taxation has no effect on executive performance and, therefore, no effect on corporate efficiency. It is thus contrary to the last two pillars of the trimodal theory, which assumes that taxation is important since it affects the net-of-tax remuneration and hence (a) the level of management efficiency and discipline which managers are prepared to accept and (b) the recruitment to the profession of management and consequently the basic capacity of managers to maintain relatively high standards of efficiency.

This chapter considers the logic of this counter-theory in the general context of human abilities being essentially simply a factor of production like capital, raw materials or land, and in the context of choice of career and employment. We must, however, first briefly review some of the factual background.

The pricing system and the educated labour force

Economically, human abilities can be regarded simply as a factor of production and the remuneration which they receive simply the price of these abilities. The function of differences in the prices of such abilities (i.e. differences in remuneration for different abilities or uses of abilities) is to reflect their economic value and serve to draw them into those uses in which they will be economically most effectively and therefore beneficially applied.

The human resources with which we are concerned in this book are those possessed by members of the educated labour force (here defined as males with graduate level or equivalent educational qualifications). In total this part of the labour force is relatively small—only 1.5 million in 1965 out of a total labour force of 26 million.

The distribution of the total educated labour force between different occupations and sectors of the economy is shown in Table 2.1. It is

Table 2.1

Distribution of the male educated labour force between public and private sectors 1961 (10% sample)

Public sector:	%
<i>Government officer (Central and Local)</i>	4.0
<i>Education (university and other teachers)</i>	14.6
<i>Sub total</i>	18.6
Private sector:	
<i>Administrators and Managers</i>	37.0
<i>Professional and Technical</i>	44.4
<i>Sub total</i>	81.4
<i>Total</i>	100.0

Source. Table 31 xxiv and xxv, Census of G.B. 1961 Summary Tables.

seen that the category 'Administrators and Managers' accounts for some 37 per cent of the total. Hence in considering the pricing system represented by executive remuneration we are considering a system which affects a very substantial proportion of the educated labour force. Moreover, from the numbers involved (and the standards of abilities required) it would seem unlikely that this proportion could be adequately staffed, as a minor profession might be, by those for whom it is vocationally the preferred career choice largely irrespective of relative financial remuneration. Hence the pricing system has a function in this profession (as with others) of attracting to it an economically efficient share of the nation's educated labour force.

Industry, in attracting its share of additions to the educated labour force (principally university graduates), is mainly in competition with the public sector service industries (teaching, academic life, Civil Service and local government), and, as regards recruiting to the

profession of management, in competition with alternative specialist professions (such as science and engineering). The share of industry and the public sector service industries in the employment of male graduates in 1964/65 is shown in Table 2.2.

Table 2.2

Distribution of male university graduates gaining employment at home by employment

Employment sector	University Faculty				Total %
	Arts %	Social studies %	Pure science %	Applied science %	
<i>Public service</i>					
<i>(other than Education)</i>	3.0	2.4	3.3	2.4	11.1
<i>Education</i>	11.2	5.0	12.5	2.1	30.8
<i>Industry and Commerce</i>	5.1	7.3	17.6	20.1	50.1
<i>Other employment</i>	2.6	3.6	1.3	0.5	8.0
<i>Total</i>	21.9	18.3	34.7	25.1	100.0

Source. First Employment of University Graduates 1964-65, University Grants Committee, Tables A, F, and 17-24 inclusive.

It is seen that the private sector which accounts for the employment of some 81.4 per cent of the whole educated labour force, recruited only 58 per cent of new graduates. In the case of non-science graduates some 54 per cent entered the public sector service industries while the whole of industry and commerce accounted for only 31 per cent.

This apparent imbalance of recruitment of graduates is due to a complex of factors. In part it is caused by the perhaps exceptional expansion of the public sector service industry in recent years. But it is also due in part to the fact that academic qualifications are substantial vocational assets in teaching, academic, and to a lesser extent, other public service careers where they are of little direct value in industry. For example a degree in languages is a substantial qualification for a career as a teacher, but it is no particular qualification for a career in industry. The description 'non-vocational' as applied to the bulk of university education in the UK is, in fact, largely a misnomer. In any society in which education takes up 31 per cent of all university graduates a non-vocational education is at least a vocational qualification for teaching in this 'non-vocational' system.

Given that business studies are generally not taught (and perhaps should not be taught) at undergraduate levels, industry, in the recruit-

ment of graduates, must combat a system of education which has a general bias (save for applied technology) towards the public sector service industries. This problem may be particularly acute as regards graduates who achieve exceptional degrees. These are assured of a distinguished career in their special subject and hence are least likely to be attracted to industrial careers in which their specialisation generally has little career value.

It is not the case, therefore, with the existing educational system and the existing differentials in remuneration between industry and the public sector service industries, that there is reason to expect or evidence of a marked preference for employment in industry by recruits to the educated labour force. The differentials in starting levels of remuneration between employment in industry and the public sector service industries are, in fact, relatively small,¹ largely because of pressure from public sector professional unions to establish comparability with industrial salaries.

The before-tax differentials in salary are certainly substantial at the higher levels of industry compared with the public sector service industries. As noted earlier the average salary of directors of the hundred or so largest companies in 1965 was £13,000 compared with £8-9,000 for the thirty highest paid posts in the civil service. But this substantial difference is largely negated by taxation which reduces the net of tax differential to around £1,100 per annum.

In sum it may be said that the pricing system for the allocation of the educated labour force between the different employments and its effective utilisation have been substantially modified (if not largely eliminated), by institutional forces on the one hand and high personal taxation on the other. This modification of the effectiveness of the pricing must be assessed in the context of other institutional factors (the size of the public sector service industries and the bias of the educational system towards these industries), directing a large proportion of graduates—and particularly the more gifted graduates—away from management careers.

Taxation of factors of production

With the exception of taxation of earned income, the taxation of basic factors of production, such as gas or electricity or capital equipment, has in general been avoided, and the bulk of taxes has been levied on end products such as spirits, motor cars, etc. Indeed taxation has

¹ See Merrett and Monk, *op. cit.*, pp. 20 and 21.

generally tended towards the positive subsidisation of capital equipment through the investment grant system. A consideration which militates against taxation of basic factors of production is the extent to which such taxation would lead to mal-utilisation of resources—the utilisation of economically more costly resources simply to avoid paying the taxation on alternative highly taxed resources.

The more valuable human abilities—where the value is taken as the price received for these services in the shape of remuneration—are, therefore, distinguished among the basic productive resources by being subject to very heavy rates of taxation. For example, as the present survey shows, director levels of remuneration (which average about £12,500) are subject to an average tax rate of 47 per cent. In addition to being subject to this high average rate of tax on the price received for such abilities, the tax is, as with no other productive resource, subject to very severe progressiveness—the average rate of tax paid on any additional earned income at director levels of remuneration is around 60 per cent.

Possible economic effects

The *possible* economic ramifications of such taxation of basic economic resources can be illuminated by considering the analogous situation in which similarly progressive taxation is imposed on the rent or the capital received from each acre of land rented or sold on the open market. To make the situation more completely analogous we should also assume that the ownership of land, like human ability, is private and not corporate—that is, the owners of the land are private individuals and not companies.

If such progressive taxation were applied to the rent or capital received from selling such land on the open market, we should expect to see it result in the owners of the land tending to withhold more of it from the open market and to apply it to uses which gave them personal satisfaction—for example, retaining the land for use as part of their private dwellings or for country estates. For the personal enjoyment from private use of land (like the individual's private use of his own time and energy) would not give rise to tax liability while, in contrast, bringing the land into economic use and sacrificing this personal enjoyment by placing the land on the open market would give rise to substantial tax liability on the revenue and capital received. Apart from this allocation of land away from its most economically desirable use, we would also expect to see land inadequately utilised. For example, we would

expect to see the owners of the land, even where it was being put to some commercial use, being less interested in getting intensive use of their land by redevelopment or better techniques, since again the increasing effort required to bring this about results in increasing taxation of the rewards for that additional effort.

The direct taxation of human ability by income tax and surtax on a progressive scale is, in principle, identical to such taxation of land or any other factor of production. Human abilities will be directed away from their most economically desirable use. For example, they will be directed towards more leisure. Similarly they will be used less intensively when they are put to commercial use, i.e. used less intensively during the working day. The reasons for this are exactly analogous to those which produced similar effects in the example of land being subject to highly progressive taxation: the benefit from private use of leisure is not taxed and the benefits from work and the intensive utilisation of abilities are.

The analogy of progressive taxation of land (or any other natural resource) on a per unit basis may serve to draw out another point. Very few would seriously deny that such progressive taxation of natural resources on a per unit basis would have an extremely serious effect in bringing about maldistribution and under-utilisation of such resources. If this is the case, then individuals holding this opinion, while rejecting the view that progressive taxation of human resources has a similar effect, must contend that in this latter case there are *very substantial countervailing influences* which correct this misallocation and under-utilisation.

Essentially it would be necessary to argue either (a) that human beings have a sufficiently strong inherent propensity to employ themselves in the most economic occupations and, when employed, utilise their abilities to the fullest practicable extent—regardless of the extent to which taxation absorbs the economic benefits from choice of occupation or choice of intensive effort, or (b) that no practicable difference in net remuneration such as could be brought about by changes in taxation could have any worthwhile effect in correcting the maldistribution and mal-utilisation of human abilities.

As regards (a) however, it is a distinctive feature of the use of human resources, compared with natural resources, that the use of human abilities (in the sense of choice of occupation and choice of company) depends on personal temperament of the human being concerned, on education and on the influence of parents, teachers and society. In the

absence of difference in net remuneration there is no reason why these forces should direct individuals who have the required abilities into being engineers rather than school teachers, or managers rather than civil servants, merely because it would be more economically advantageous to the economy to have engineers and managers rather than school teachers or civil servants.

In so far as choice of occupation can be influenced, it is only either through the direct manipulation of the educational system or through higher net remuneration being offered to those who choose to take up the employment most economically advantageous to the economy. As was noted earlier, our own system of education at university level is strongly biased in non-scientific education towards training graduates for the Civil Service, local government and teaching professions. These occupations absorb over 50 per cent of all non-scientific graduates. This in itself is largely an accidental result of tradition rather than the outcome of economic forces. With the possible exception of some forms of scientific education, it certainly could not be argued that our educational system is effectively directed to obtaining the most economic use of human abilities.

Ultimately, therefore, we must rely upon differences in salaries between occupations, that is the pricing system for human ability, to persuade parents and educators to direct human abilities to those employments in which they would be most economically beneficial. But it is precisely this pricing system for the most valuable resource that is substantially negated by taxation absorbing a high proportion of the differences in price offered for taking up different employments or working human resources more intensively and, therefore, weakening the incentives which differential salaries should have in bringing about a more economic allocation and utilisation of human resources. Hence the basic contention of those who argue against modification of the tax system in order to obtain better allocation and utilisation of our educated labour force must be (b) above, namely that no practicable change bring about a worthwhile improvement.

Choices and management efficiency

To examine this contention more clearly we need to look in more detail at the choices which influence management efficiency, both in terms of the allocation and utilisation of human resources. The allocation and utilisation of human resources in the economy is decidedly more complex and varied in its potentialities than with any other natural

resource. Figure 2.1 illustrates the very large number of choices which bear upon the efficient utilisation of the sort of abilities possessed by the educated labour force. (In the context of this book it is primarily members of the educated labour force with which we are concerned since it is primarily from the ranks of this group of society that future managers will be drawn.)

Choice of	Education and development	Public sector Private sector Public sector service	Industry	Standard of management efficiency
Basic alternatives	1. Applied technology 2. Sciences 3. Social sciences 4. Arts	<i>Industry</i> 1. Public sector service industries 2. Private industry	1. 'Safe' industries 2. 'Problem' industries	1. Companies with high standards of management efficiency 2. Companies with low standards of management efficiency
Influences	1. Parents 2. Schools 3. Ultimate financial reward	1. Prior training and education 2. Job environment 3. Ultimate financial reward	1. Job environment 2. Ultimate financial reward	1. Job environment 2. Ultimate financial reward

Figure 2.1. Management choice and management efficiency

As illustrated in the figure there are four basic choices (although these break down into a great variety of particular choices within these main categories). The initial choice is as regards training and education received by the as yet potential member of the educated labour force. A large variety of choices open up, ranging from applied technology to arts subjects. At this very early stage in the individual's career he is allocating his abilities between these training and educational alternatives, and his choice will significantly influence the economic value of his abilities in later life. Thus if abilities utilised in applied technology are of more value to the community than abilities directed towards pure

science or arts subjects, a basic allocation of resources will arise at this early stage when a choice is made for one or the other.

The second major choice is between careers in the public sector service industries (Civil Service, local government, teaching and academic life) compared with careers in the private sector either in industry or the service industries.

For those opting for the private sector there is a further basic choice as between the safe and established industries represented by the giant companies and the 'problem' industries comprising companies in the grip of basic economic problems (shipping, coal, textiles, etc.) and industries struggling with technological problems (aircraft, computers, etc.).

The final and basic choice for individuals in particular industries and companies is as regards the standard of management efficiency which they are prepared to accept. This standard of efficiency will depend first, on the *level of effort* which executives are prepared to maintain. This level of effort will evidently embrace actual hours worked but will also take into account the actual effort during the hours worked.

The second factor effecting the standard of management efficiency is the *direction of the executive's effort*. This is principally the extent to which the executive is prepared to accept that his effort must be directed towards those activities which increase the efficiency of the company rather than provide him with agreeable opportunities for exploiting his particular professional or functional skills. In concrete terms this means the extent to which managers in the research and product development departments of the company are prepared to accept direction of their research and development towards greater profitability and away from less profitable research of greater professional interest; the extent to which production line managers are prepared to accept the pursuit of profitability rather than production and engineering for its own sake, and the extent to which sales executives are prepared to accept the pursuit of profitability over the easier task of simply achieving increases in turnover.

The third factor affecting the standard of management efficiency is the *standard of management discipline* which the manager is prepared to accept. By this is simply meant the acceptance by managers of the necessity for high standards of management efficiency, and the concomitant acceptance of the company's right to impose such discrimination in terms of salary and such sanctions, in terms of demotion or

dismissal, as will sustain this high standard of management efficiency.

Clearly, in this general context the corporate standard of management efficiency is of fundamental economic importance. To argue that managers in companies automatically pursue the goal of maximum profitability and, therefore, generally the maximum efficiency of the company, is to argue in the face of the most common experience of the problems of managing major companies. It is indeed to argue against the whole trend of modern economic thought, which has in various ways tended to argue that managers in large modern corporations pursue functional interest, growth, etc., and place relatively little emphasis on maximising corporate profitability.¹ (It is also to argue against the common evidence that companies taken over or threatened with takeover frequently produce very substantial increases in profitability of which there was no indication prior to the threat or fact of takeover.) The fundamental problem of modern management in large corporations is essentially the control of such tendencies and the direction of management effort by high standards of management discipline and incentives towards the goal of profit-increasing efficiency.

In describing this standard of efficiency we have stressed the acceptance of this as being primarily a matter of the manager's own choice. The manager exercises this by his choice of company and function within the company, since different companies and functions require substantially different levels of managerial efficiency.

The company itself can evidently *seek* to impose a high standard of management discipline. But there are two basic problems. First, it must obtain acceptance of the need for such higher standards at top management level and gain the acceptance of such standards as applying to top management itself. Second, it must gain acceptance of these higher standards throughout the company. It cannot *impose* these standards without the managers' acquiescence since it cannot impose on any manager the obligation to work for the company, and still less, in the context of recruitment, can it oblige managers to join the company and accept these standards of efficiency and discipline.

Thus we see that members of the educated labour force (from which managers must be expected to be drawn) are called upon to make a very large variety of choices affecting the development, allocation and ultimately the utilisation of their abilities. In their initial training and education, they are primarily subject to the influence of parents and

¹ See, for example, the extensive analysis in Richard M. Cyert and James G. March, *A Behavioural Theory of the Firm*, Prentice Hall, 1963.

educators. The parents, however, are usually themselves subject to the influence of the ultimate career prospects of the educational pattern which they attempt to persuade their children to accept. In this way the ultimate financial reward offered by different professions influences basic training and education.

In the choice between the public sector service industries and private industries the major factors influencing the choice will be the individual's prior training and education, the relative attractiveness of the two-job environments (including the security of employment and freedom from stress which they offer) and again the ultimate differences in financial reward which these alternatives offer.

Similar factors influence the individual's choice between 'safe' and 'problem' industries.

As regards the final choice, namely the level of management efficiency which the individual is prepared to accept, the dominant consideration (at high levels of efficiency which almost by definition are likely to be uncongenial to the individual concerned) must be expected to be the additional *net* financial compensation offered, compared with companies making smaller demands on their managers. It is, for example, hardly conceivable that a large proportion of managers would be prepared to work for companies which imposed very much higher standards of management efficiency in return for no net increase in remuneration compared with companies which made much lower demands.

A particular consideration in this regard is the fact that high management standards must be expected to involve a higher degree of financial risk from the greater chance of demotion or dismissal, that is, must impose a correspondingly high standard of management discipline. Again the manager is not an isolated unit as regards this fundamental choice since the demands which the company makes in terms of hours and energy, and the risks which it imposes, involve disadvantages to the manager's family and family environment. Unless this could be made up to the rest of the family group by improved material prospects, a natural regard for the overall welfare of the family must be expected to impel managers to reject posts which are not compensated for high standards of management efficiency.

In this section we have tried to explore the grounds for the contention that no change in the tax system could bring about a worthwhile improvement in either the allocation or utilisation of management (or potential management abilities). Essentially this contention is seen to rest on the argument that no practicable change in taxation could bring

about a worthwhile improvement in either (a) educational, developmental or career choices, or (b) in the standard of management efficiency which such tax changes could enable companies to achieve. Since little research has been undertaken into either (a) or (b) in this country there is clearly no evidence to support dogmatic assertions. It was to obtain some empirical evidence for a considered judgment that the survey work of this study was undertaken.

Issues (a) and (b) above are evidently not those which are commonly considered in the context of management incentives. Thus issue (a) would involve studying the effects of taxation on the pricing system for human abilities and the way in which this affects the whole series of choices open to possessors of exceptional economic abilities. Conventional analysis of the problem typically revolves round the fundamentally naïve question as to whether or not individuals would 'work harder' if they paid less in tax.¹ In the context of management, incentives this is merely a small part of the, in itself, limited question (b) above, namely the question of the relationship between net remuneration and standards of management efficiency.

Moreover, in the context of these past surveys into taxpayers generally, it should be noted that in the case of managers their immediate reaction to any specific change in the tax system *cannot usefully be considered in isolation from the reaction of companies themselves*. An issue which must be considered is the extent to which companies would exploit opportunities arising from tax reform in order to organise larger net incentives (and correspondingly higher penalties) for executives, and so corporately move to a higher standard of management efficiency than is practicable under the existing tax system.

In this general context surveys into whether or not individuals would 'work harder' under some alternative (and usually unspecified tax system) is analogous to asking soldiers if they would fight better if they were more highly paid. Such a question is of limited relevance to higher payment for soldiers, since the major effects of such higher payment would probably be (1) a higher standard of individuals recruited to the military profession, and (2) the opportunities which higher remuneration in holding and attracting adequate personnel would present for *imposing* higher standards of efficiency.

¹ See second report by the Royal Commission on Taxation of Profits and Income, Appendix I: George F. Break, 'Income Tax and Incentive to Work', *American Economic Review*, September 1957, and *The Graduate Appointments Register*, April 1967.

The theory and the survey

As we have stressed in the introduction to Chapter 1, any evidence as to human motivation in so complex an environment as that of a large company will inevitably be fragmentary, and conclusions will need to rely extensively on the balance of probabilities. It should be remembered, however, that in the context of corporate policy towards remuneration and public policy in fiscal matters, the balance of probabilities must itself be evaluated in relation to the corresponding probable economic benefit which might arise from an improvement in executive efficiency—that is, we must consider the magnitude of the benefits attaching to the balance of probabilities. Given the crucial responsibility of executives for the organisation and efficient utilisation of the nation's resources, the possible benefits from higher levels of executive and corporate efficiency may be very considerable.

The remaining chapters of this book are, therefore, concerned with attempting to evaluate the trimodal theory of executive remuneration and efficiency in the context of a survey of UK directors and a comparative analysis of UK and US executives in the light of this and other surveys.

The first of the two principal objectives of the survey of UK directors was to collect some basic information on the income, taxation and wealth of UK senior management. This basic information is evidently an essential prerequisite of any evaluation of the connection between net remuneration, wealth and management efficiency.

The second objective was to obtain from senior management an assessment (*a*) of the extent to which their executives would respond to net incentives and (*b*) the extent to which they were conscious of problems of management discipline arising from the scale of net remuneration of executives in the UK.

Given the interrelated nature of the information required, it was essential for the survey to cover a wide range of questions and it was therefore necessary to confine the survey to the relatively small number of fifty-one directors. The results must be regarded as subject to these limitations of sample size.

The methods and results of the survey are described in the following chapters. In the penultimate chapter we also attempt to relate these findings to those of other surveys of American experience in order to determine what light international comparisons may throw on the relationship between executive remuneration and corporate efficiency.

Conclusions

It has been stressed in this chapter that taxation of human abilities, through taxation of income, is taxation of a basic factor of production, that this factor of production is exceptional in this respect and unique as regards the rates of progressiveness of such taxation. The basic question which had to be considered was the effect this may have on remuneration as the pricing system which allocates human abilities to different employments and supports their efficient utilisation in those employments.

In the particular context of executive remuneration the rates of taxation are exceptionally high—an average rate of 47 per cent and a marginal rate of 60 per cent at the director level. The first issue which had to be considered was the extent to which this restricted the capacity of industry to obtain a standard of recruit to the profession of management which the efficient economic working of the modern corporation required. Four important factors are:

1. The very considerable relative size of the profession of management (some 37 per cent of the whole educated male labour force).
2. The relatively small net-of-tax differential between, for example, corresponding levels in the Civil Service and industry—some £1,100 per annum at the highest comparable level.
3. The very wide range of choice open to new recruits to the educated labour force and in particular the wide range of vocationally attractive professions in education and public service (these two absorbed some 42 per cent of all male university graduates in 1964–65 while the whole of industry and commerce absorbed only 58 per cent).
4. The bias of the UK's university education towards careers in the public sector service industries, particularly for the more gifted graduates.

The second major issue is the extent to which increased differences in net remuneration would make executives prepared to accept higher standards of management efficiency and management discipline. The advantages of this had to be interpreted in the light of the modern methods of control in large corporations (in particular the broadening of the base of profit responsibility) and the increasing complexity and potential profit instability of the large corporation owing to breakdowns in management efficiency and discipline.

In this larger context it is evident that relative levels of remuneration

have some influence on corporate efficiency. The point at issue on executive remuneration and public policy on taxation is whether or not any practicable change would bring about a commensurate improvement in corporate efficiency. This and related problems are explored in the following chapters.

The method of the survey

The method of the survey was that of asking senior management in private industry to complete a questionnaire on income, taxation and wealth, and to agree to an extensive interview and discussion in which certain topics were preselected and introduced by the interviewer. A decision was taken at the outset to confine the survey to full-time directors of companies.¹ There were a number of reasons for this.

The first was simply that it was of crucial importance to discriminate between the relative authority—in terms of experience and seniority—of the respondents in the sample. Any simple ‘nose counting’ survey in which the assessments of possibly quite junior managers in small companies could be counted equally with the assessments of directors of major companies are likely to be valueless. By confining the survey to directors whose relative importance and experience could be ascertained from the net assets of the companies by which they were employed, the opportunity was gained to weight the answers in a rational manner. This opportunity would have been impossible had the analysis ranged over a large number of managers at different levels, whose relative importance it would be difficult to gauge objectively.

The second reason for confining the survey to directors was that these would be likely to have had broad experience of the responsiveness of executives to financial incentives since an essential function of most company directors is that of gauging individual performance and utilising financial and other incentives in order to attain corporate efficiency.

The third reason for confining the sample to directors was an entirely practical one. Directors comprise a reasonably identifiable group of managers and are listed in the records of institutes and published accounts. No corresponding list of managers in general exists.

¹ In fact, at the outcome, one director had just gone into semi-retirement, and another within the last twelve months. Both were retained in the sample, where relevant.

In view of the complexity of the problems considered by the survey, the method of detailed interview and discussion with a limited sample was chosen rather than a more superficial analysis of greater numbers based on postal questionnaire or short interviews. In addition, the opportunity which detailed discussion provided for obtaining some qualitative assessment of the relative importance of different issues was obviously of importance and preferable to less intensive techniques.

Structure of the sample

Ideally, one sample should have been taken from all companies, but unfortunately no list of all companies classified by size is available. Therefore it was decided to sample from both quoted and unquoted companies. In the case of quoted companies, the Board of Trade list was used. This list, published annually, covers only 2,000 companies out of the total of some 4,300 quoted companies, but these 2,000 own or effectively control virtually the whole of the quoted sector.

The sample of directors from these 2,000 companies was obtained by using the list of the companies in descending order of size of net assets, and then by breaking the list down into three different strata shown in the first two columns of Table 3.1. Companies were chosen at random from each strata and a director of that company chosen, also by a random technique, from the directors listed in the company's report and accounts.

Table 3.1

Quoted company sample structure and directors interviewed

No. of Companies	Percentage of net assets	No. of directors interviewed
1 to 15	0 to 25	3
16 to 200	26 to 75	12
201 to 2,000	76 to 100	9
<i>Total interviewed = 24</i>		

In addition to these quoted companies there are some 500,000 other companies of greatly varying size and importance. About 77 per cent of these other companies do not file accounts and there was no publicly available list of these companies. The most comprehensive private list is that maintained by the Institute of Directors. This list does not embrace all unquoted companies, but it might appear that there is no positive reason for supposing the list to be significantly biased, as regards the characteristics being measured by the survey, compared with

all unquoted companies. A further advantage of the Institute's records was that they also contained information on the age and proprietorial interests of the directors—variables not determinable until actual interviews in the quoted sample. Utilising this information, the sample of unquoted company directors was chosen in the manner shown in Table 3.2. Before the interviewing sample was structured, the records were sampled to determine the average size of company. This proved to be £229,000 of issued capital and reserves. Companies above this are referred to as 'large' companies, others as 'small' companies. Similarly the records were sampled to determine the average age and the relative number of directors holding proprietorial interests. Subsequently, in order to include some directors aged under fifty-five, who were working for 'small' companies and having a proprietorial interest in the company, a complete list was made from the Institute's records of directors in this category and a sample of four chosen at random.

Table 3.2

Unquoted company structure and directors interviewed

	Large Co. under 55	Small Co. under 55	Large Co. over 54	Small Co. over 54
<i>Proprietorial interest exceeding 5%</i>	6	4	2	3
<i>Proprietorial interest less than 5%</i>	5	2	3	2
<i>Total interviewed = 27</i>				

It will be noticed that the unquoted sample is structured in terms of age and proprietorial interest in addition to the company size structuring used in the quoted sample.

The comment that the responsiveness to monetary incentives will differ between individual managers, though obvious, was one which needed some thought before the survey could begin; the more accurate the reasoning, as shown by the subsequent survey, the more reliable would be the results of the survey.

To begin the survey, it was necessary to structure the people to be interviewed into categories which are relevant to management incentives. Thus, *a priori*, we had to estimate those factors which would affect the responsiveness of the individual manager to a monetary incentive. The first factor that might affect responsiveness is the wealth of the individual manager. If the manager had a large amount of capital in the form of a home, land, shares, etc., then we would argue that he

was less likely to make the extra mental and physical effort that a response to a purely monetary incentive would require. Equally, we would argue that the manager with little or no wealth and a mortgaged home would be more likely to respond to a monetary bargain. In between the extremes it is possible that there would be a spectrum of responsiveness. Even so, care would have to be exercised, since the manager's behaviour might also reflect habit. For example, a manager might be very wealthy, but if he had accumulated the wealth himself from nothing, then his behaviour patterns might have become set towards responding to a monetary incentive. Or, if the large amount of wealth had been inherited, the manager might be used to a life free from monetary problems and one in which money had always had a subsidiary effect on his behaviour.

Another variable, which *a priori* might be expected to influence behaviour, is age. The director who was in his seventies might reasonably be expected to be less dynamic and energetic than the director in his thirties. Clearly, this variable could operate independently of wealth for it will be physically more difficult to summon the extra effort when age is advancing.

Wealth and age were thus two of the variables to which our survey was to be directed. The records of the Institute of Directors were of especial use, since not only was company size given (and hence our weighting of the importance of the director obtainable) but also age. In addition, the existence of proprietorial interest was used as a proxy for the existence of wealth. For the quoted companies, structuring, as seen above, had to be compared with company size since, until the publication of this work, no data (and therefore no list) exists of quoted company directors in terms of age or wealth.

For the discussion of some factors on the effects of taxation upon management efficiency, for example, a discussion of hours of work, a classification by the variables of age and the source of wealth might be more relevant than a break down into quoted and unquoted company directors. Such a classification is given in Table 3.3.

Table 3.3

Classification for discussion of management incentives

Inherited wealth		Self-made wealth		Salaried and professional	
Under 55	Over 54	Under 55	Over 54	Under 55	Over 54
5	1	4	9	20	12
<i>Total interviewed = 51</i>					

The classification is broken down into directors whom we describe as 'salaried and professional', 'self-made wealthy' and 'inherited wealthy'. The directors were classified into these categories on what can be described as a common sense basis. The salaried and professional group were chosen primarily on the basis of our file and not of the directors' behaviour. The remaining directors were classified on the basis of the source of wealth. (The actual data are presented in the next chapter.)

A cross-classification is given in Table 3.4, showing that the behavioural groups are almost equally split between the quoted and unquoted company samples.

Table 3.4

Cross-classification of samples

	Quoted	Unquoted	
<i>Salaried and professional</i>	15	17	32
<i>Self-made</i>	6	7	13
<i>Inherited</i>	3	3	6
	—	—	—
	24	27	51

To obtain the fifty-one directors for interview involved approaching 104, on the basis of initial approach, reminder and then replacement from the same sample category. In all, fifty-six agreed to be interviewed, five of whom were subsequently eliminated. One was too busy until the report was due, and four were eliminated through inability to tie up wealth forms returned anonymously. Of those who replied, but refused to be interviewed, the reasons were as follows:

- 5 retired or semi-retired
- 1 dead
- 1 subsequent death
- 1 ill health
- 1 'personal' reasons
- 1 resident in USA
- 2 on business in USA
- 1 rejecting the value of a survey since the answer that taxation was a disincentive was obvious.

There did not appear to be any significant difference in the response rate between the quoted and unquoted samples. The overall acceptance rate of 56 out of 104 is good, and compares well with an American study¹ which obtained only a slightly higher response rate after as many as nine follow-up requests by post and telephone.

On the basis of the interviews, we do not believe that the fifty-one directors who are included in the sample represent a group with any over-interest or lack of interest in the question of taxation and management efficiency.

¹ Robin Barlow, Harvey E. Brazier and James N. Morgan, *The Economic Behavior of the Affluent*, The Brookings Institution, Washington, 1966.

The survey on income, wealth, taxation and hours of work

The sample of fifty-one directors consists of a sample of twenty-four quoted company directors and a sample of twenty-seven directors drawn from the Institute of Directors records, covering a wide range of unquoted companies. In estimating such characteristics as the average income for directors in general, it is not possible to combine the two subsamples statistically, since there is no statistical basis for weighting the results from these two separate subsamples as components of a parent population. In other words, we do not know what number of directors are accounted for by the total number of quoted companies compared with the total number of unquoted companies, or the total net assets for all companies or unquoted companies. Where there are likely to be differences, for example income, as between the two subsamples, we will, therefore, indicate the result for each.

In measuring some characteristics, for example, hours of work, we revert to the categorisation of salaried and professional, self-made wealthy and inherited wealthy, given in Chapter 3. As regards these characteristics we are assuming that there will be no difference whether the individual is in a quoted or unquoted company—that is, where this categorisation is used, we assume that the salaried manager has the same characteristics whether he is in a quoted or unquoted company.

Finally, to avoid constant reiteration in the text it must be stressed here that our results are drawn from a sample size of only fifty-one directors and any conclusions drawn from our results must be subject to the statistical errors consequent on this small sample size. The questionnaire itself is reproduced as Appendix A. Detailed results of the survey are given in Appendix B.

Income and tax

The average total income of the directors in the quoted sample was £12,500 and the average of the directors in the unquoted sample was

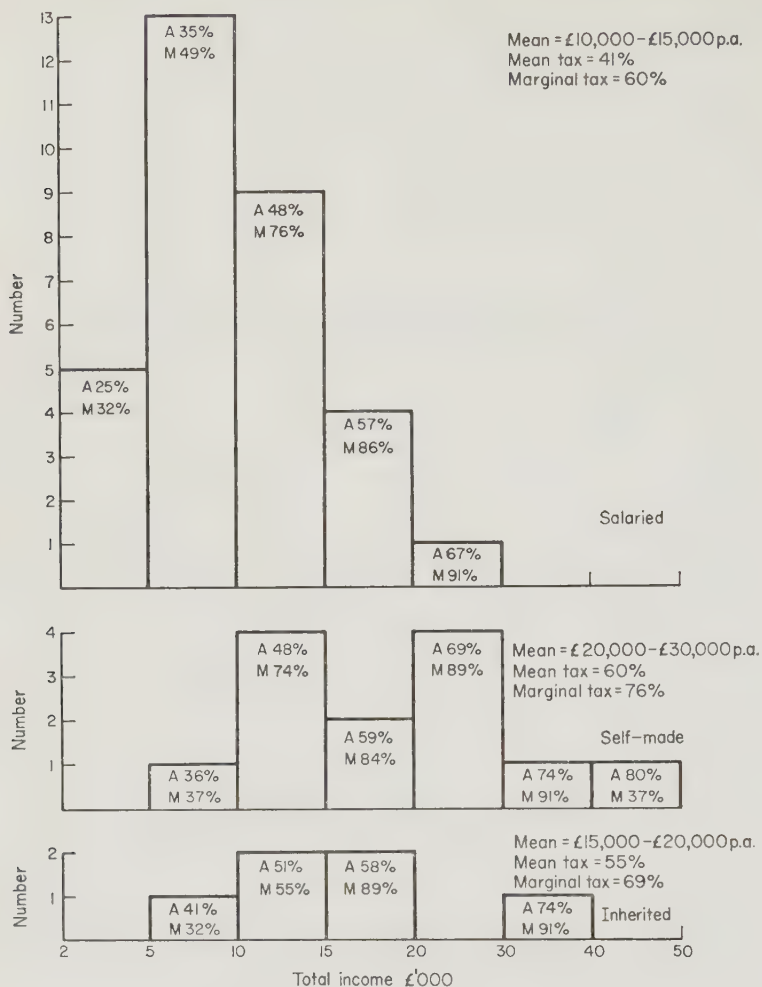


Figure 4.1. Total income—by category

Note. In each bar, the upper figure shows the mean of the average tax rates for the directors in that category of income; the lower figure shows the average of marginal rates of tax on earned income for the same directors.

£7,500.¹ The distribution of average income as between salaried and professional, self-made wealthy and the inherited wealthy, is shown in Figure 4.1. It is seen, for example, that the most common salary range

¹ These are mid-points of income ranges.

for the salaried and professional management category was between £5,000 and £10,000 with an average in the range £10,000–£15,000. Of this total income some 80 per cent on average was earned, though

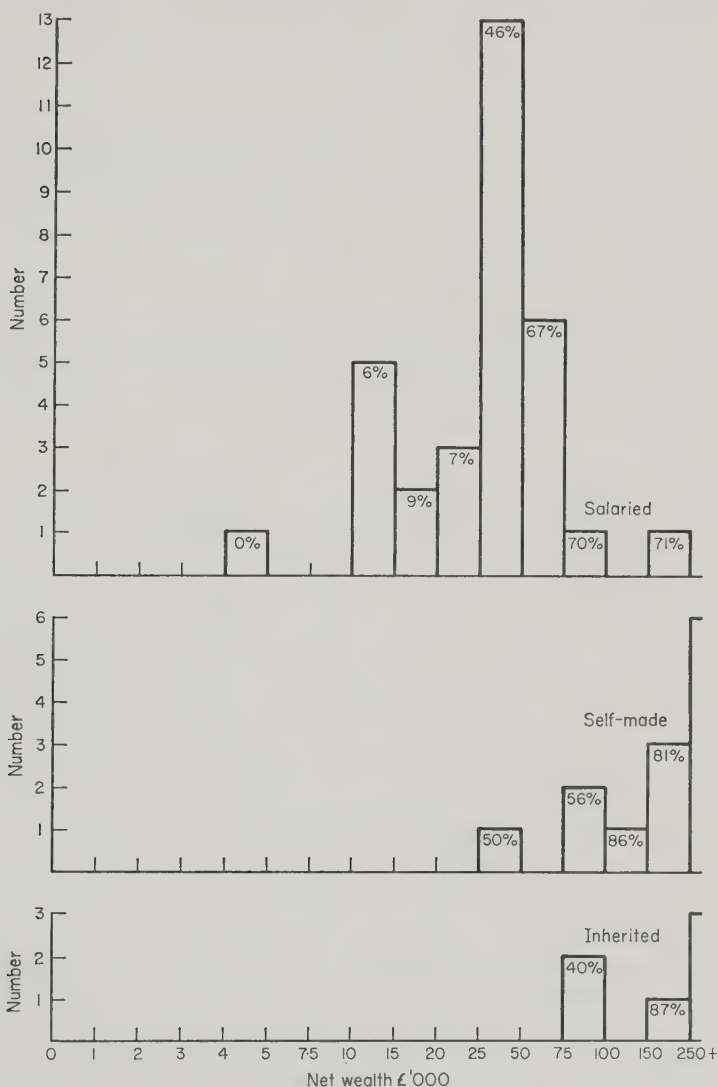


Figure 4.2. Net wealth by category

Note. In each bar, the figure represents the disposable wealth in that category of net wealth as a percentage of the total net wealth in the category.

90 per cent and 100 per cent were each more common. As might be expected the self-made wealthy and the inherited wealthy had higher average total incomes of £20,000 to £30,000 and £15,000 to £20,000 respectively. In particular, these two groups accounted for the three directors in the sample who had incomes in excess of £30,000. The average earned income was only 50 per cent and 60 per cent for the two groups.

The tax rates of these directors are also shown on the figure. Thus it is seen that the most common average tax rate of salaried and professional directors was 35 per cent. But, the most common marginal tax rate (the tax imposed on additional earned income) was 49 per cent. On average for the group, the average tax rate was 41 per cent, with a marginal tax rate of 60 per cent.

In the case of the self-made and inherited wealthy, there is no most common average or marginal tax rates, but, on average, the amount of current income paid in tax was 60 per cent and 55 per cent respectively, with marginal rates of 76 per cent and 69 per cent.

Net wealth and disposable wealth

The most useful analysis of net wealth is in terms of the actual distribution of wealth among recognisable categories of individual, in our case the categories salaried and professional, self-made and inherited wealthy.

It is in the nature of analysis of wealth that general averages are of little usefulness. This is because the distribution of wealth tends to be so irregular that the average wealth of any group of individual corresponds to no recognisable entity. This is illustrated in Figure 4.2, which shows the distribution of wealth as between the groups of directors in our sample. It is seen from this that the range is enormous—from one director (salaried and professional) having net wealth of £4,000–£5,000 to the nine directors (self-made and inherited wealthy) who had net wealth in excess of £250,000. In general, our common sense basis for allocating the directors might seem to be justified. The salaried and professional distribution is seen to be to the left of the two other distributions, and in only two cases did net wealth exceed £75,000.¹

¹ On re-examination, no directors were classified out of the category chosen on common sense grounds. In the two cases referred to here, the net wealth had arisen from marriage in one case, and from extremely generous treatment by the owners of the (unquoted) company in the other.

A substantial part of net wealth is in the form of houses, and a significant proportion of this would not be the result of capital accumulation through saving, but simply the effect of inflation and house prices since the time the houses were purchased. Figure 4.2 also shows the proportion of the wealth of individuals within each net wealth category, which consists of other than the house in which they live, and sums assured on life policies. This measure of wealth is referred to as disposable wealth. Thus, we do not expect either home or life policies to be regarded as a reservoir of wealth available for emergencies such as loss of employment.

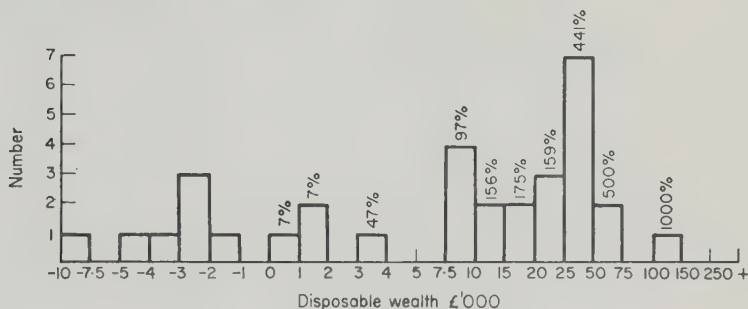


Figure 4.3. Maximum disposable wealth—salaried directors

Note. In each bar, the figure represents total income in that category of disposable wealth as a percentage of the total net wealth in the category.

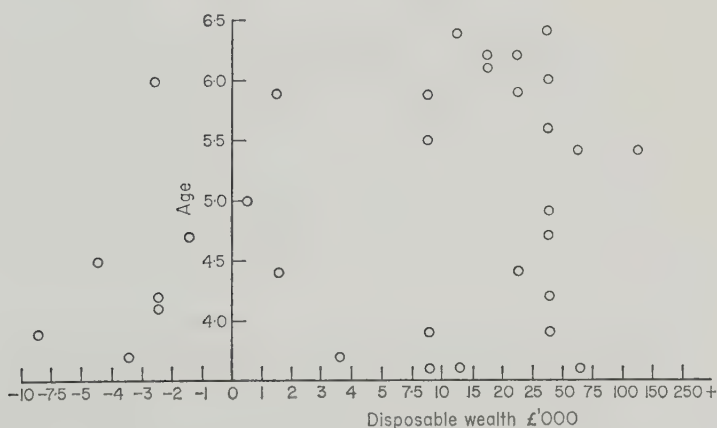


Figure 4.4. Relationship of age to disposable wealth—salaried directors

The percentage in Figure 4.2 shows that disposable wealth declines as a percentage of net wealth as net wealth decreases. This means that for many in our sample, there is only a small amount of 'reservoir wealth' available. The lack of any reservoirs of disposable wealth might reasonably be expected to inhibit executive mobility. For example, the executive with little disposable wealth will not be keen to incur the monetary costs involved in a change of job and location, and that seniors will be less prepared to exercise the sanctions of dismissal, redundancy or early retirement.

In the context of mobility and the disposable financial resources which directors might accumulate, it is, therefore, useful to look at this figure of the actual disposable wealth which they possess. In particular, in the case of salaried and professional directors, this is shown in Figure 4.3, where a new distribution is produced by allocating directors to their disposable wealth category. The distribution of disposable wealth is seen to be extremely large—ranging from *indebtedness* of £10,000 for one individual, to disposable wealth of £100,000–£150,000 for another. It is seen that around one-quarter of the salaried directors had no disposable wealth (in fact net indebtedness) and that almost one-third had less than £1,000–£2,000 of disposable wealth. The third of directors who had either indebtedness or minimal disposable wealth cover a fairly wide span of ages—from thirty-seven to sixty, as is shown in Figure 4.4. The directors possessing larger amounts of disposable wealth (the group shown in the figure as having £7,500 or more) was somewhat older than those possessing minimal wealth, though there is no very clear correlation between age and disposable wealth, even for this primarily salary dependent group of directors.

If these statistics are representative of all salaried directors, we infer the following conclusions. First, that a third of directors had negligible disposable wealth, and indeed that the majority of these would have net indebtedness. Second, nearly two-thirds of all directors will never obtain disposable wealth in excess of £20,000—in Figure 4.3, nineteen out of thirty-two directors had less than £20,000 of disposable wealth.

In the context of management mobility and management discipline, it is illuminating to look at director wealth in terms of the percentage which this represents of the before-tax salary. This is shown in Figure 4.3. For example, for the seven directors in our sample who had disposable wealth between £20,000 and £25,000, this constituted 159 per cent of their before-tax incomes. Thus, in terms of wealth, the

rewards of a management career would appear to be modest—the probability of the director ever achieving disposable wealth greater than about twice his before-tax salary are relatively small. In fact less than one-third of salaried and professional directors ever achieve this small distinction.

Hours worked

The respondents in the survey were asked a number of questions regarding their hours of work where these were defined as all hours spent wholly or in part working for the company and, therefore, included business lunches and business entertainment. The object of these questions was to obtain basic information on this discussion of management effort, in order to discern the possible scope for additional work effort and to make comparisons with other studies.

Our estimates of the working week of directors is given in Table 4.1 for three categories of director and all directors. The average hours worked of salaried and professional management is seen to be around fifty-three hours per week, although there is a considerable variation around this, for example, the top quarter of salaried and professional managers were found to work nearly sixty-three hours per week.

The fifty-three hours for salaried directors may be compared with the average of forty-two hours for senior and middle managers as ascertained by an earlier study.¹ It also lends some support to the view expressed in this earlier study that higher management tended to work longer hours than middle and junior management.

Our sample of the inherited wealthy is probably too small to draw any firm conclusion, but the sample in the survey in fact worked an average of only seventeen hours per week, while the self-made wealthy, a larger sample, worked about forty-seven hours per week.

Finally, as regards this question of hours of work, it must be stressed that we are dealing with only one dimension of actual work effort. The other dimensions are the efficiency with which the manager works in terms of the increase in the company's profitability which results from his hours of work. This efficiency may take the form of deployment of essentially superior abilities or greater actual effort during the hours of work in the sense of the manager undertaking uncongenial, difficult and tedious tasks, when he has the opportunity of in fact reducing his work load by selecting more congenial, less difficult and more interesting tasks. It should also be stressed that the other dimensions of work

¹ See Rosemary Stewart, *Managers and Their Jobs*, Macmillan, 1966.

Table 4.1

Estimate of working week

	Mon.-Fri. Hours	Sat. Hours	Sun. Hours	Total Hours
<i>All</i>	9 × 5	1½	1¼	47¾
<i>Salaried and professional</i>	10 × 5	1¾	1½	53¼
<i>Self-made</i>	9 × 5	1	1	47
<i>Inherited</i>	3 × 5	1½	½	17

Note. The mean for each category of director and all directors is taken to be the mean also representing the distribution of hours normally worked by one director, by multiplying by 5 a typical working week is thus obtained.

effort become increasingly important as the director increases in seniority in the company and, therefore, has greater scope to increase or reduce his actual work *load* by his selection of tasks to which to devote his hours of work, for example, selecting easier rather than difficult tasks so as to reduce his work load.

Bonus schemes

Directors in the survey were asked to give details of any bonus schemes in which they participated. These schemes were defined to include all forms of bonus payments, stock options, etc.

Slightly less than half (twenty-four out of fifty-one) of the directors surveyed participated in some form of bonus scheme and in the case of salaried manager eighteen out of thirty-two participated in such schemes. Of the twenty-four schemes, seven appeared to be of the type that represented no incentive effect whatsoever. In other words, a bonus was expected, of an anticipated size regardless of personal or company performance. Of the seventeen remaining schemes, the percentage of total income accounted for by the scheme was known in only nine cases. This varied from 1 per cent to 67 per cent. Of these, five might be expected to be of insignificant effect in terms of remuneration, while four would in all probability materially affect the director.

It is difficult to judge the actual practice of bonus schemes, in the light of the majority of companies preferring salary remuneration to bonus remuneration. The general impression gained was that some bonus schemes for senior management were largely a formality and that others were of little practical importance relative to total remuneration. Only in a minority of cases would it appear that the bonus scheme

materially effected the remuneration of the director concerned. This is in very marked contrast to the US as will be seen in Chapter 7.

Conclusions

While not wishing to discount the substantial contribution which other groups may make to the economy relative to their numbers, the main stress in the conclusions of this chapter must be on the salaried and professional managers who control the great bulk of the nation's economic resources in the private sector. The average income for this group was in the range of £10,000–£15,000.

The average tax rate imposed on the average income was 49 per cent. The average tax rate on additional income (the marginal tax rate) was 60 per cent and almost half had a marginal tax rate of 76 per cent or more.

The wealth of salaried and professional managers varied enormously from negligible amounts to between £150,000 and £250,000. (In only one of the two cases in our sample in which the net wealth exceeded £75,000, however, had this arisen from employment rather than marriage or inheritance.)

In terms of disposable wealth (that is cash and securities) a third of salaried and professional directors had negligible wealth and the majority of this third net indebtedness. Nearly two-thirds had less than £20,000. In interpreting this it should be noted that these directors had an average age of 49 and 40 per cent were 55 or more.

Disposable wealth should also be looked at in the context of the executive's probable way of life as indicated by his salary. This may have an important bearing on the extent to which the company may be prepared to use the sanction of dismissal in the case of inadequate management. (The serious financial consequence to managers resulting from dismissal was alleged—see Chapter 6—to result in unwillingness of management to use this sanction against inadequacy.) Less than a third of the salaried professional directors had achieved, despite their relative age, more than twice their before-tax salary in terms of disposable wealth.

It must be concluded, therefore, that the rewards arising even from careers resulting in directorships and primarily in quoted companies are relatively modest. Moreover as was seen from Chapter 2 the differences and net-of-tax remuneration between directors and corresponding grades of the Civil Service are also relatively small.

In the light of these statistics of relative income taxation and wealth

it would be difficult to argue that the career of management was one offering decisive financial advantages relative to other careers leading to similar seniority. Moreover, as is analysed in Chapter 6 these differentials in salary both gross and net are fractions of the corresponding differential existing between management remuneration and that of other occupations open to members of the educated labour force in the United States.

As regards hours worked it was found that directors worked relatively long hours with an average of fifty-three per week and with a top quarter working nearly sixty-three hours per week. This is in marked contrast with the forty-two hours per week of senior and middle management ascertained in an earlier study. Insofar as hours of work are thought of as an important dimension of work effort¹ there is scope for significant additional work effort, but this is decidedly more marked at senior and middle management levels. This lends some support to the view that there is a need for higher standards of management efficiency at lower levels of management particularly (see Chapter 1) in the context of need for higher levels of management efficiency being required at this level to take up the increasingly substantial devolution of profit responsibility.

¹ This is certainly the commonly expressed view of United States companies—see Editors of *Fortune*, *The Executive Life*, Doubleday, 1956.

Remuneration and management efficiency

In this chapter we give the main results of the questionnaire and discussion part of our survey. The basic objective of this part of the survey was to obtain firsthand assessments of the possible impact of remuneration and taxation on management efficiency *as regards those aspects of management efficiency of which the interviewee had firsthand knowledge*. Given this objective it was necessary to allow the discussion to become fairly free ranging in order to ascertain the background and experience of the interviewee. The questionnaire was, therefore, used primarily to structure a discussion which, in those areas where the respondent had significant experience was further extended but with detailed files notes kept of both questions and responses.

The whole range of questioning and discussion was confined to the issue of the various possible effects of remuneration and taxation on management efficiency as regards individuals already having adopted the profession of management. No questions were put as to the effect of taxation on recruitment to the profession of management since there was no reason to suppose that a substantial proportion of the directors would have any significant knowledge in this respect.

While a number of questions were put as to the respondents' own work effort this formed only a minor part of the survey. It was accepted from the outset that it would be difficult to obtain any reliable indication of the total impact of remuneration and taxation on work effort by questioning the individual. A basic difficulty is simply the strongly emotive attitudes of senior management to their level of work effort. It is part of the ethos of senior management that they are working to the limit of their capacity, and for a manager to indicate to the contrary is probably regarded as tantamount to admitting to unfitness for the position of which he holds.

Moreover there is the additional difficulty of interpreting the value to be placed upon the work effort of executives given, as we have

stressed, the direction of effort (whether applied to increasing the profitability of the company rather than satisfaction of professional or personal interests) is also important in evaluating the manager's work effort. In view of the impracticality of enquiring among other directors on this point it was decided not to direct the survey towards this difficult question but to concentrate on the directors' evaluation of the work effort of others. The exception is as regards possible work effort in the shape of outside directorships, where it was assumed the emotive connotation of questioning the manager's fitness in his existing employment could be avoided.

Finally it should be noted that in this chapter the answers are not weighted by the relative importance of the company concerned (or the importance of the size of company in industry). The classification of respondents in the sample is also not on the basis of quoted and unquoted companies but on the basis of salaried and professional, self-made wealthy and inherited wealthy.

Incentives within the existing job

General questions about the general effect which changes in remuneration and taxation of an unspecified nature might have on the efficiency of managers within their existing employment are largely futile, or too vague to be capable of rational answer. The particular circumstances and the magnitude of the change together with the particular categories of managers to whom it was likely to apply are essential if an accurate assessment is to be made.

The specific question (with several associated subsidiary questions) which was put to the directors in the sample was:

'One way of achieving an improvement in performance would be to get each director and executive to secure an increase in profit or a cut in costs. Suppose you and the other responsible directors were granted the power to hand out a tax-free sum of money equal to 10 per cent of your executive and directorial payroll to the directors and executives, earning more than £5,000 p.a. Do you think this would enable you to obtain an improvement in general efficiency and profitability that would enable the company to recoup this 10 per cent addition to its serving executive payroll costs?'

The basic point which this question and its subsidiary questions seek to illustrate is whether or not the existing tax system, by relatively heavy taxation of additional payment for additional effort, was limiting

or prohibiting companies from getting more efficiency from their middle and senior management. In putting this general question the directors were asked a number of subsidiary questions concerning existing various schemes operated by their own companies and general views on special payments for special effort.

The response to this particular question is as shown in Table 5.1, broken down by the background of the responding director.

Table 5.1

Taxation and incentive payments

Question: Would tax-free bonus payments pay for themselves?

	Salaried professional	Self-made wealthy	Inherited wealthy
<i>Yes</i>	26	7	3
<i>No</i>	6	6	3

If taxation has no effect on management efficiency the logical answer to this question would be: 'No, our executives work as hard and efficiently whether additional remuneration is taxed heavily or not.'

It is seen that 80 per cent of the directors classified as salaried and professional and over a half of the wealthy answered this question in the affirmative.

The affirmative answers were generally emphatic and accompanied by supporting comments as to the importance to the company of being able to remunerate additional effort in this way. One respondent expressed the situation graphically, by saying that the present situation was one in which a minimum of one-third and generally well over 50 per cent of any such bonus payments made to executives earning more than £5,000 in his own company would be absorbed by taxation. Hence if bonuses were very lightly taxed (as in the case of American style stock options) we were really considering bonuses 50–100 per cent, or several times greater than those which could be offered under the present tax regime.

While strongly in favour of 'payment by results' he pointed out that the successful operation of a company on this basis depended on the company's top management taking the initiative as regards profit-increasing activity and devoting considerable time to evaluating the profit contribution of senior management. But in his view it was not possible, under the existing tax regime, to enable top management to

participate substantially in the profits which arose from their additional effort, and this constituted a significant handicap to the effective utilisation of incentives.

Another director (one who had made a fortune in his own lifetime and was operating a system of 'payment by results' for his own senior management) stressed the importance of take-home pay in enabling the dedicated executive to compensate his family for the not inconsiderable sacrifice which they have to make through the executive's long hours at work and long absences on sales trips abroad. In this director's experience the possibility of substantial benefits accruing to the executive's family was a generally important incentive, but in the case of the executive whose work involved long hours and repeated absences from home it was a 'vital necessity'.

The two directors in the survey who were particularly experienced in international businesses involving considerable foreign competition and exporting, were very much concerned with the problems of remunerating their UK executives adequately relative to their foreign counterparts, in order to prevent the wastage of staff to foreign companies and also in order to maintain staff morale where these were in contact with relatively junior managers in foreign subsidiaries who were enjoying a substantially higher standard of living. (This was particularly a problem as regards Canadian and American subsidiaries or parent companies.)

Table 5.2

	All	Salaried and professional	Self-made wealthy	Inherited wealthy
<i>Higher net remuneration would permit higher standards of management discipline</i>	23	17	6	—
<i>Management already as exacting as practicable</i>	5	1	1	3
<i>Unable to comment</i>	11	4	5	2
<i>Total</i>	39	22	12	5

Management discipline

There has been a substantial move in the UK over the last decade or so towards management control systems (see Chapter 1) based on cost centres, specific budgeting and profit responsibility. The essential aspect of these systems is the attempt to hold managers responsible for

profit contributions to the company, either by their control of costs or revenues or both. The extent to which this form of management improves efficiency depends crucially on the standard of management discipline—that is the extent to which it is possible to make managers *accept* high standards of performance and hold them responsible for obtaining them. There is some objective evidence supporting the suggestion that the standard of management discipline in this sense is lower in the UK than in the US, and a number of questions were put to directors to obtain their views on this important issue.

This is a complex question and useful comment on it requires extensive experience of alternative methods of management control systems and general experience of management in large companies. For this reason discussion of this problem was confined to directors of large companies. Nevertheless a substantial proportion (eleven of the thirty-nine) with whom this problem was discussed thought they could offer no useful comment, generally from want of experience.

Of the remaining twenty-eight directors with whom the problem was discussed twenty-three considered the possibility of higher net remuneration of executives would make it possible to obtain a higher standard of management efficiency. It is difficult to convey the balance and emphasis of comment on this critical question statistically, but the following specific comments were made.

A common comment was to the effect that management discipline required large incentives associated with large penalties and that it was not possible to impose large penalties (in the shape of the only ultimate penalty which the company has, namely dismissal) for failure if it was not possible to offer correspondingly large benefits for success.

Another director added that it simply was not good business in the UK context to impose anything like the standard of discipline which efficiency required, since in the UK quite senior managers rarely had sufficient capital to avoid dismissal being the most serious financial hardship. Managers generally were not prepared to accept this kind of penalty when there was nothing of commensurate value in terms of remuneration which the company could offer. (This point was put lucidly by one director who remarked that incentives are largely absorbed by the Revenue while the anguish and anxiety of dismissal or the threat of dismissal are not.)

Among those expressing concern on the question of management discipline there was general agreement that since it was impossible to offer managers even the modest wealth which would make them secure,

it was necessary to offer them security of employment, even though this frequently ran counter to the financial efficiency of the company.

The majority of these directors also commented on the already difficult problem of the financial worries and insecurity of many of their younger managers.¹ The view generally put was that younger managers (rightly or wrongly from a social point of view) were attempting to give their children a private education on top of substantial financial commitments in the form of mortgages, etc., and as a question of simple arithmetic this was extremely difficult to do at UK salaries and UK tax rates. Given that financial anxiety was already so common among executives and already impairing their complete involvement in their work, it was not practical to talk in terms of tightening up management discipline to enforce higher standards of management efficiency unless managers could be provided with the higher net-of-tax incomes or the wealth (such as might arise from American style stock options) which would enable them to withstand the financial stress involved in greater executive mobility resulting from a more exacting system of management discipline.

Most of the directors concerned were very much aware of these particular problems and volunteered examples of managers who were being retained in nominal positions, or people that they would prefer to dismiss if these individuals had the financial resources to make this reasonably humane. Others stressed the necessity for rewarding the now inadequate manager for past good service in the only way practicable under the existing tax regime, namely by continued employment despite the fact that this lowers the morale of their younger and more capable junior staff.

Another director stressed the cumulative effect of 'carrying' inadequate managers in senior positions. His general view was that the problem of management discipline and management efficiency was particularly acute as regards relatively senior managers or even directors who have a record of very considerable past achievements but who were now, through age or changing conditions, proving to be seriously inadequate. He thought the cumulative effect of keeping on even a relatively small number of these people where they were in a position to block new initiatives to higher efficiency was extremely serious, but in terms of morale and the justice of the matter it was equally serious

¹ This view is supported by the statistical analysis of Chapter 4 which indicated that some 31 per cent of salaried directors had less than £2,000 of disposable wealth and 20 per cent of these has negative amounts of disposable wealth.

to dismiss them. The same director added that if these directors had received net-of-tax remuneration commensurate with their past contributions to the company they would be, by this time, relatively well off. In such circumstances he thought he would have no compunction in requesting their resignation. They would have been remunerated for past services, would possess sufficient resources to cushion the effect of dismissal, and would have seen from the beginning that the possibility of termination of employment was the other side of the coin of large incentives and large remuneration in earlier years.

(Actual cases of directors or senior executives being dismissed, or being asked to resign, appeared to be rare. The convention, when it became impractical for the director or senior executive to continue in his present post, was to promote him sideways.)

Personal effort and remuneration

The initial response of directors to test questions on the effect on their own effort of changes in remuneration (either before or after tax) was generally that they were already working 'as hard as they could' and no change in remuneration or taxation was likely to influence them. As a literal statement, and even having regard to the intensity of work (in so far as it could be ascertained from the interview), this statement was generally inconsistent with the respondent's stated hours of work—for example only a quarter of the salaried and professional directors worked the sixty-hour week which might be regarded as literally meaning 'as hard as possible'.

Further discussion revealed (as hypothesised in Chapter 2) that a large proportion of the respondents were extremely defensive on this question and would have regarded the statement that they were working 'less hard than they could' as a severe criticism of themselves in their role as directors. Moreover, it proved difficult to break through this barrier of defensiveness, particularly with older directors.

In support of their general claim that they could not be influenced by changes in remuneration might be adduced the fact that the majority, even of the salaried and professional directors, were in their fifties, when work habits are likely to have become fixed by habit and the opportunity for further advancement becomes limited. On the crucial related question of the effectiveness of their work effort in terms of profitability it was not practicable to enquire.

It should also be noted that the question of management discipline as applied to executives at director level is particularly complex, in

that the board of directors is to a large extent a self-disciplining body setting its own standards of executive efficiency. This is in contrast with executives below board level whose standard of efficiency and level of discipline is imposed on them.

Useful determination of the response of senior directors to changes in remuneration and taxation would require an assessment of the longer term impact of such changes on the collective levels of efficiency and discipline which the board imposes on itself. If, for example, we were considering the impact of stock options which made the increases in wealth of members of the board to a significant degree dependent on their collective actions, we should have to consider the extent to which this would make the board more prepared to vote for profit-increasing measures or elect (where they have the opportunity) directors more likely to increase the profitability of the company, and the extent to which they would vote to demote or dismiss inadequate members of the board. These are the major possible impacts of changes in remuneration and taxation at director levels of efficiency. Such effects could only be revealed by detailed interfirm comparisons in companies practising different forms of executive remuneration, but this is hardly practical given that the structure of UK taxation does not permit experiment with lightly taxed forms of executive remuneration.

Among younger directors (under forty-five) there were indications, despite their being among those working longer hours, that they would be prepared to accept (indeed would have sought) opportunities for substantially greater profit-increasing effort, provided this led to rewards enabling accumulation of significant amounts of wealth. The wealth in question appeared to be relatively modest and amounted to perhaps a quarter or third of their salary as an annual amount. (It is seen in Chapter 6 that in the US stock options provide opportunities for accumulating annually wealth equal to about one-third of the executive's before-tax salary.)

Among directors who were led to respond explicitly, the general view appeared to be that increases in their productivity would require substantially greater effort since it would involve tackling major problems (e.g. problems of overmanning or product redevelopment). As such it would require a substantial alteration in the time which they could devote to family life. The compensation for this discontinuous and significant change in the character of their private life was only likely to be acceptable if compensated for by genuine 'payments by results' on a scale which led to modest independence in terms of wealth.

Attitudes to outside directorships

It was thought that a useful indication of the directors' general attitude to additional effort might be obtained from asking questions relating to the terms on which they would be prepared to take outside directorships. Their willingness or unwillingness and the terms on which they might take on outside work, it was thought, would be free from the biases which were likely to effect their answers as regards their capacity or their willingness to undertake more effort within their existing employment.

A difficulty in this sort of question is the implied nature of the outside directorship in question and questions were therefore posed in terms of whether the director would be willing to take on outside directorships where financial consideration only was involved, and if so on what financial terms they would be prepared to undertake such work.

A substantial proportion of company directors were found to be not allowed to take on outside directorships. Of those who were so allowed their replies to questions as to whether they would be prepared to undertake outside directorships are given in Table 5.3. Eight of the twenty-seven directors replied that they would be prepared to take on outside directorships with relatively slight regard for the remuneration involved. The most commonly given reason for this interest in outside directorships was the desire of the director concerned (they were generally towards the younger end of the age distribution in the sample) to obtain greater experience and thus ultimately become more effective managers.

Table 5.3

Outside directorships

	All	Salaried and professional	Self-made	Inherited
<i>No, not allowed</i>	14	11	2	1
<i>Yes, if sufficiently interesting</i>	2	2	—	—
<i>Yes, mentioning only gross- of-tax sums</i>	6	4	1	1
<i>No—time</i>	6	5	—	1
<i>No—other reasons</i>	4	1	1	2
<i>No—net-of-tax insufficient</i>	15	8	6	1
<i>Not recorded</i>	4	1	3	—
	—			
	51			

Four of the directors were not prepared to consider outside directorships for a variety of non-financial reasons of which the most common was that they had insufficient time. Fifteen expressed the view that the net of tax remuneration from outside directorships was inadequate compensation for the additional work involved. With typical remuneration for outside directorships being between £1,000 and £2,000 for some perhaps twenty to forty days of work per year, the net-of-tax remuneration which they might receive would be in the region of £17 per day from £50 gross.

The directors responding in this sense were asked to name the sort of net-of-tax remuneration which would induce them to take on such outside directorships. In general the sums proved to be relatively modest—typically around £30 per day. At the marginal rates of tax of these directors, however, this would have involved remuneration for outside directorships of £86 per day. These sums are generally quite outside the range of most part-time directorships.

Subject to all the qualifications as to size of sample and the reliability of the individual's expression of his own motivation, this appears to indicate that taxation is a deterrent to additional work in the form of employment outside the existing job. The remuneration offered for the employment in question would generally be sufficient to lead to such employment being taken up in the absence of heavy taxation; but given the fact of tax rates of 65 per cent at the margin such work would not be taken up.

In general as regards directors we are led to conclude (*a*) that there is scope for additional work in terms of hours conventionally worked and (*b*) that there is some evidence of willingness to take on additional work for additional remuneration. The extent to which either of these two characteristics could be exploited to make managers more efficient in the context of their existing jobs must turn upon the extent to which other factors tend to raise the standard of work effort required by managers. The factor most obviously within the control of public policy is that of taxation of the remuneration received by managers.

Conclusions

As has been stressed in earlier chapters the complexity of human motivation and corporate efficiency must limit the potential usefulness and qualify the results of any survey based on the evaluations of individual managers. In this survey, however, an attempt was made to improve the efficiency of such surveys by concentrating on well-

defined categories of executives whose experience might make these evaluations of genuine usefulness.

On the question of whether or not taxation impaired the efficiency deployment of incentive payments an overwhelming preponderance of salaried and professional directors were in the affirmative (twenty-six in the affirmative relative to six negative).

Similarly as regards management discipline, seventeen out of the twenty-two salaried and professional directors were of the opinion that higher net remuneration would permit higher standards of management discipline. It is impossible to summarise the comment and stress of the replies to this question, other than to say that by their emphasis, detail and cogency, they lent considerable weight to these affirmative answers. Moreover, the minimal disposable wealth of many directors, as ascertained in Chapter 4, confirmed the practical difficulties of imposing higher standards of discipline, while information on hours worked by middle management (see Chapter 6) supports the contention of considerable scope for higher standards of management discipline.

As regards directors themselves it proved, as expected, impossible to determine the possible effects of changes in net remuneration on their own work effort, given the extent to which this would depend on the complexities of the collective self-discipline which the board of directors as a whole might impose on its members and the difficulty of obtaining any independent assessment of the directors' work effort. Hours of work and willingness to take on outside directorships (where the net-of-tax remuneration was adequate) indicated some scope for positive response to greater incentives.

In general the results of the survey supported (but by its own nature could not prove) that practicable differences in remuneration and changes in taxation could significantly affect management efficiency and discipline. In this respect the survey supported the central pillar of the trimodal theory of executive remuneration (see Chapter 1), which postulates that higher net remuneration would make executives accept higher standards of efficiency and discipline.

Executive efficiency and remuneration: UK and US

In the main the evidence of the previous chapter would seem to support the trimodal theory of the relation between executive remuneration and efficiency as discussed in Chapter 1. But this evidence is essentially that of assessments of *future* possible reactions of executives to alternative systems of net remuneration.

It is, of course, inherently impossible to obtain evidence of what will *actually* happen without actual experiment, but it is possible to throw some light on this by considering alternative systems of remunerating executives in different countries and the extent to which these are consistent with alternative theories of remuneration. Such international comparison between the UK and US executive is attempted in this chapter.

Relative remuneration UK/US executives

To consider the implications of American evidence we must first consider the relative remuneration of comparable executives in the two countries. This is attempted in Table 6.1. The comparison of this table is based on that of a UK managing director compared with a US chief executive, where both are employed by companies of comparable turnover. In this comparison we have two very similar employments of companies of comparable size.

The table shows the typical size and composition of net tax remuneration of the two executives in £stg at an exchange rate of \$3.41 to the £.¹ It is seen that the UK executive receives the whole of his £14,000 of remuneration in the form of salary while the US executive receives almost a third of his salary in the form of stock options—that is capital gains arising from the executive's exercise of his option to purchase

¹ This is the official United Nations Exchange Rate for determining salaries of United Nations officials in the two countries and may, therefore, be regarded as a viable estimate of the relative cost of living in the two countries.

Table 6.1

Relative remuneration of UK managing directors and US chief executives in 1965

	UK	US
<i>Before-tax salary</i>	14,000*	26,650*
<i>Stock options</i>	—	12,200†
<i>Total remuneration</i>	14,000	38,850
<i>Total remuneration less tax</i>	6,900*	27,500*

<i>UK and US managing directors: Relative remuneration in own country</i>		
	UK managing director	US chief executive
<i>Multiple of earnings in own country of earnings of:</i>		
<i>Labourer</i>	17‡	35§
<i>Skilled worker</i>	12	21

Sources

* A. J. Merrett and D. A. G. Monk, *Inflation, Taxation and Executive Remuneration*, Hallam Press, 1967.

† Daniel Holland and Wilber G. Lewellen, 'Probing the Record of Stock Options', *Harvard Business Review*, January, 1966.

‡ *Ministry of Labour Gazette*, October 1966.

§ *Statistical Abstract of U.S.*, 1966, and *Employment and Earnings*, U.S. Department of Labour, August 1967.

the company's stock at favourable prices. The before-tax remuneration of US executives is seen to be some $2\frac{3}{4}$ times that of the UK executive and in net of tax terms to be four times as great as that of his UK colleague.

The differences in remuneration between the two countries are evidently made up of two factors: (1) the higher real income generally in the United States; (2) the relatively higher remuneration of US executives relative to US workers generally. This aspect of executive remuneration in the two countries is explored in the lower part of Table 6.1. This shows that the US chief executive earns thirty-five times the earnings of the American labourer and twenty-one times the earnings of the American skilled worker. In contrast the UK managing director earns seventeen times the earnings of the UK labourer and twelve times that of the UK skilled worker. These statistics in fact imply that *over half the difference between US and UK executive remuneration is accounted for, not by differences in relative incomes generally in the two countries,*

but simply by differences of relative remuneration of executives within their respective countries—that is, US executives are paid much higher multiples of the remuneration of labourers or skilled workers. There is, therefore, fairly conclusive evidence that in the United States companies remunerate executives much more highly relative to other categories than do UK companies.

Relative remuneration and efficiency: UK/US executives

Determining whether or not there is any connection between relatively higher remuneration and relatively higher efficiency is inherently difficult simply because efficiency in the context of executive efficiency is extremely hard to determine other than by reference to the remuneration which the executive is receiving. Economic theory suggests that in a competitive market free from any major distorting influences such as heavy personal taxation, individuals would receive as remuneration a sum equal to their contribution to the profitability of companies.

If this is accepted as applying both to the UK and the US, it would suggest that US executives are significantly more efficient relative to US manual workers than UK directors compared to UK manual workers. In fact the figures of Table 6.1 imply that the American executive is over 100 per cent more efficient.

A substantial qualification to this is that the UK before-tax salary figures may be significantly depressed by heavy personal taxation discouraging companies from paying executives relatively high salaries. It would, however, seem unlikely that taxation could depress UK salaries to the extent required wholly to eliminate the difference in relative efficiency in their respective countries as between UK and US executives suggested by relative differentials in their own country.

Some further evidence of differences in efficiency between the average UK and US executive can be gleaned from considering the relative hours worked and the mobility of management in the two countries. As we have elsewhere stressed (see Chapter 4), hours of work are only one dimension of the executive's work effort; the other dimensions of work effort, namely the activities to which the work is applied and the manager's personal efficiency within any given number of hours, are obviously also very important. Nevertheless hours of work may give some indication of at least one dimension of the relative work effort of managers in the two countries.

Management mobility is also, up to a point, undoubtedly conducive to management efficiency in that it provides for circulation and, there-

fore, probably more effective utilisation of executive abilities. It may also be indicative of a higher standard of management discipline resulting from more frequent dismissal.

The statistics available on these two characteristics as between UK and US management are subject to a number of imperfections and must be used with considerable reservations. In particular, hours worked are subject to the uncertainty of classifications of hours spent on combinations of work and leisure—for example, business entertainment.¹ Such information as is available is presented in Table 6.2.

Table 6.2

UK and US managers: Hours worked and mobility

	UK	US
<i>Hours worked per week</i>	42-53*	57-60†
<i>Mobility</i>		
<i>Per cent having worked for</i>		
<i>more than 1 firm</i>	66.4‡	75§
<i>more than 2 firms</i>	44.4	52

Sources

* Rosemary Stewart, *Managers and Their Jobs*, MacMillan, 1967.

† Fortune, *The Executive Life*, Dolphin Books, 1956.

‡ D. S. Clark, *The Industrial Manager*, Business Publications, 1966.

§ W. Lloyd, Warner and James C. Abegglen, *Occupational Mobility*, Minnesota Press, 1955.

The figure of forty-three hours per week for the UK relates to senior and middle management generally below the level of directors considered in our sample.² The fifty-three hours per week relates to the average hours worked of salaried directors in our own sample.

Subject to the above qualifications these figures do suggest that UK executives work significantly fewer hours per week than their US counterparts, with the main difference in the ranks of the less senior executives.

As regards management mobility it would again appear that there is significantly more mobility among American executives than their

¹ It is also probable that the American figures are somewhat exaggerated. The survey by Robin Barlow, *et al.*, *op. cit.*, found the median hours worked of the affluent to be forty-eight per week although this included retired and partially retired individuals.

² See Rosemary Stewart, *Managers and Their Jobs*, Macmillan, 1967.

UK counterparts. Thus Table 6.2 shows that some 75 per cent of American executives had worked for more than one company compared with 66 per cent of all UK executives.

Relative efficiency UK and US companies in Britain

Some further evidence of higher standards of executive and corporate efficiency in US companies compared with UK companies is to be found from considering the relative performance of subsidiaries of American companies in the UK compared with other comparable UK companies. A detailed comparative study over a wide range of US subsidiaries in the UK¹ indicated that the American companies earned a substantially higher return on capital than the British companies both in manufacturing industry as a whole and in individual industries. Among the explanations advanced for these differences in profitability were (1) the greater amount of research and managerial knowledge available to the US companies; (2) better formal qualifications of their executives; (3) the US contribution in both departmental and managerial techniques.

The explanations commonly advanced for these differences in profitability, namely some direct or indirect subsidisation by the American parent company, and differences in the industries in which the US companies were involved compared with the average UK company, were not found to account for more than a minor part of the differences in profitability.

The degree of local autonomy possessed by the UK subsidiary of the US parent varies considerably from company to company. In general the most common pattern appears to be that of controlled decentralisation for the US parent with the local subsidiary acting on much the same basis as a division or subsidiary in the United States, that is, being held accountable to the centre in terms of planning and budgeting and responsibility for achieving set profitability standards. There is little evidence that in terms of formal management techniques (as opposed to motivation and efficiency in the deployment of techniques) the US subsidiaries are on average superior to comparable UK companies.

The same study, however, did indicate the marked relationship between the formal qualifications of executives and the profitability of the companies for which they worked. The results are given in Table 6.3.

¹ See Professor John H. Dunning, 'US Subsidiaries in Britain and Their UK Competitors', *Business Ratios*, Autumn 1966.

Table 6.3

Proportion of executives having university degrees or equivalent formal qualifications

%	No. of firms in sample	Return on capital
0-24	26	13.5
25-49	31	17.9
50-74	29	19.5
75 and over	18	23.8

There is unfortunately no detailed information on the levels, methods and tax characteristics of remuneration received by senior executives working for US subsidiaries compared with UK companies, although it is known that a relatively high proportion (relative to UK companies) practise discriminatory bonus schemes and, in some cases, make available lightly taxed remuneration in the form of payment for executive services rendered outside the UK.

If the results of this study are accepted it would confirm the scope for significantly higher standards of executive and corporate efficiency in the UK. It would also confirm the importance in such efficiency of recruiting from the most highly talented of the educated labour force (in so far as formal qualification can be regarded as associated with this characteristic).

Finally, as regards the effect of net-of-tax remuneration on the profitability of these companies, we can only observe the combined effect of American and UK remuneration since effective control of the company is divided between the UK and the US. The fact of US subsidiaries with US managing directors (whose net-of-tax remuneration will generally be immediately or ultimately made up to US standards) achieving substantially higher rates of return (26.4 per cent) compared with those with UK managing directors (16.5 per cent) does, however, support our theory of the relative importance of corporate efficiency of senior executives being highly remunerated and motivated towards profitability.

Recruitment to the profession of management: UK and US

The economic importance of the recruitment of high standards of individuals to the profession of management was stressed in Chapter 1 and forms, in fact, the third pillar of the trimodal theory of the relationship between executive remuneration and corporate efficiency. The above study of UK and US companies operating in the UK appeared

to confirm the importance of recruiting managers with formal qualifications (although their superior efficiency may reside simply in the fact of individuals with superior abilities tending to be qualified rather than the qualifications themselves).

If it is accepted that a partial explanation of the superior efficiency of US executives is the recruitment of higher standards of abilities to the profession of management, we need to consider the reasons for this. It is undoubtedly the case that the relative prestige of the executive career is considerably greater in the US than in the UK, but this cannot be divorced from the relatively high remuneration of US executives (compared, say, with manual workers). As we have seen, the differentials are very much greater than in the UK.

The trimodal theory of the relationship between executive remuneration and corporate efficiency postulates that executive remuneration, relative to that of other occupations open to potential executives, will influence the standard of abilities recruited to the profession of management and hence influence efficiency. International comparisons between salaries received in professions alternative to that of management are difficult to make in view of the different scope of professions in the US compared with the UK. The clearest comparison, however, is probably between senior academic appointments in the UK and US compared with managing director and chief executive posts in the two countries. In the US the multiple of a senior American professorial salary which would be received by the chief executive of Table 6.1 would be around 5. The comparable multiple for the UK managing director and the UK professor would be around 3. In terms of net-of-tax differences (which the trimodal theory postulates as the determining factor as regards recruiting into the profession of management) the multiples would be respectively 4.7 and 1.8. Although public servant comparisons are more difficult to make, such comparisons as can be made reveal similarly marked differentials between US Federal civil servants and UK civil servants. The 313 highest paid full-time Federal employees¹ in 1965 were on a salary scale beginning at £7,500 compared with £8,000 for the 30 highest paid UK civil servants. Even before tax therefore the US executive obtains more than 400 per cent more than the most highly paid US civil servant while the UK executive obtains only 65 per cent more than the highest paid UK civil servants. Thus the differentials obtaining in the United States are of an order consistent with the

¹ See 'Occupational Outlook Handbook 1966/67', *U.S. Department of Labor* and 'Recommendation of the Standing Advisory Committee,' January, 1966.

trimodal explanation of the apparent relative efficiency of American managers compared with their UK counterparts.

Conclusions

While inevitably fragmentary and highly qualified, the evidence of relative remuneration in their own country, hours of work, mobility, and the performance of US subsidiaries relative to local companies in the UK all tend to support the general impression that US executives are *on average* more efficient than the UK executives. The relative performance of US subsidiaries compared with their UK counterparts, and the higher profitability of both US subsidiaries with American managing directors in particular, indicates the scope for significantly higher levels of executive and corporate efficiency in the UK.

The fact that all these findings are consistent with the trimodal theory of the relationship between executive remuneration and corporate efficiency cannot, however, prove that the theory is true and the explanation of the relative efficiency of US compared with UK companies. It is possible that there are alternative explanations equally consistent with the evidence. But such alternative explanations would appear to amount to the proposition that the US population contains a higher proportion of inherently more gifted potential executives than does the UK and that this cultural superiority produces the evidences of higher corporate efficiency and executive remuneration. Given the diverse national origins of the leaders of American business this would seem to be extremely improbable.

Finally, we shall briefly refer to the alternative 'explanation' of any relative differences in efficiency between US and UK companies and executives as being due to some form of moral delinquency on the part of UK executives—for example the view sometimes publicly expressed that UK executives are wilfully indifferent and inadequate. This contention would be hardly worth referring to but for the frequency of its public reiteration. The presupposition of this contention is that moral motivation both can and should be utilised to resolve economic problems. Whatever the abstract ethical validity of this presupposition, there is no evidence that, save in periods of national calamity, it is possible to make moral motivation replace economic. It would, however, seem highly likely that the methods of this argument—extensive and reiterated denigration—can, by the demoralisation and diversion of attention from real remedial measures which it produces, exacerbate the problem it seeks to solve.

Implications

The purpose of theory and investigation must be to serve as a guide to policy. In this final chapter, therefore, we attempt to determine what general conclusions for corporate and public policy can be drawn from the theory, analysis and evidence of the preceding chapters.

The evidence of the survey of directors and the comparative survey between US and UK indicates significant scope for higher productivity by UK executives. It also tends to support the trimodal relationship between executive remuneration and standards of corporate efficiency. As we have seen this relationship runs through relatively high remuneration requiring the company to impose higher standards of management efficiency (to recoup the higher costs of such remuneration), the receipt of relatively high net-of-tax remuneration causing higher standards of management efficiency and discipline to become more acceptable to executives, and finally, the relatively high net-of-tax remuneration leading to a higher standard of individual being recruited to the profession of management. These are the three ways in which remuneration, both gross and net, influences the standard of corporate efficiency.

In this theory the stress is on the need of the corporation to recoup, and on *the standards of efficiency accepted* by executives and the recruitment to the profession of management rather than on the typically naïve view of the effect of remuneration and taxation on executives, which is embodied in the debate whether or not lower taxation would cause executives to *volunteer* to work harder. In the organisational context of major corporations the stress must be on standards *imposed* by the organisation through the force of competition (from other companies exploiting the more favourable tax environment) to obtain greater efficiency from their executives and hence obtaining from the *acquiescence* and *capability* of executives induced by higher net remuneration, higher standards of efficiency.

Moreover it was stressed that the context of this theory must be that

of modern methods of organisation and control in the larger corporations. It was argued that the problems of size of the modern corporation and the complexity of modern management are causing a shift away from both the highly centralised and the loosely organised confederate forms of company organisation towards that of controlled decentralisation. This involved a very considerable broadening of the base of profit responsibility among executives. The essential logic of this form of corporate organisation is that of a centre setting policy and standards of efficiency (through the budgeting and planning mechanism), continuously evaluating and monitoring the extent to which these policies and standards were being realised, and motivating the managers to whom profit responsibility had been devolved to achieve this realisation.

It was stressed that without this ability of the company to motivate realisation of its policies and standards, the loop of control could be broken and the company forced to acquiesce in basically inadequate and inefficient standards of performance.

The motivational powers open to the company are essentially three-fold. First, motivating capable managers or potential managers to join the company; second, motivating them to accept high standards of management efficiency; and third, motivating them to accept the standard of management discipline which will maintain this efficiency.

It is inherent in the numbers and standards required and in the nature of the corporate environment that companies cannot be expected to rely principally or wholly on vocational inclination and non-financial motivations to achieve relatively high levels of corporate efficiency. A particular consideration in this regard is the general trend towards greater leisure and vocational employment as evidenced by the relatively high proportion of graduates opting for careers in education, pure science, etc. This trend is probably particularly strong in the UK (compared with, say, the United States) because of the extent to which, while largely still formally non-vocational, the British system of university education is in fact vocational as regards teaching and academic careers (and to somewhat lesser extent Civil Service and local government) since qualifications in arts, social studies and pure science are substantial qualifications for those employments, while in general they are much less substantial qualifications for careers in industry.

It is possible, therefore, that substantial net-of-tax differentials in remuneration might be required between industry and other occupations open to the educated labour force in order to attract to industry the numbers and quality of management and gain the acceptance of the

standards of efficiency and discipline which are required for the efficient economic working of the modern corporation. The analysis of an earlier study indicated that in fact differences in net-of-tax remuneration between, for example, the starting grades in the Civil Service and in management were extremely small.

Despite significant gross-of-tax differences, the net-of-tax differences in remuneration in the upper ranks of management (directors in the top 100 UK companies) and the higher grades of the Civil Service (the top thirty posts in the Civil Service) amounted to £1,100 in 1965. Similarly the senior posts in industry are only 80 per cent higher net-of-tax than senior posts in academic life. In contrast in the United States senior posts in industry offer net of tax remuneration some 370 per cent greater than the remuneration received by senior American academics.

The employment opportunities open to the educated labour force in the public sector service industries (such as the Civil Service, teaching and academic life) generally offer an extremely high level of security. Moreover hours of employment (on an annual basis) could not be described as demanding. Given that these occupations provide employment for some 19 per cent of the educated labour force (compared with management's 37 per cent) it must be expected that these conditions and standards, in the absence of sufficiently offsetting net-of-tax differentials in salary, will substantially influence private sector employment in management. In the absence of natural vocational inclination or compensatingly large differences in remuneration it must be expected that individuals entering on the career of management will not be prepared to accept any higher standard of efficiency and discipline or greater insecurity of employment than exists in these alternative occupations. In sum, in the absence of substantial differences in net remuneration, it must be expected that the standards in the private sector will be dominated by standards in the comparably remunerated public sector service industries.

Implications for tax policy

The basic issue for public policy as regards taxation must be the extent to which the cost of any modification of tax system produce commensurate benefits in the shape of higher levels of corporate efficiency. These costs have been considered in some detail elsewhere.¹ Two main changes in taxation might be considered: the introduction of restricted stock options along the American pattern and reduction in

¹ See Merrett and Monk, *op. cit.*

surtax rates. Stock options allow the executive to participate in the proved profitability of the company by giving him the option of acquiring shares in the company at predetermined prices in future years. Gains are taxed as capital gains when the shares are sold. (In the UK the capital profit realised from exercising stock options would be wholly taxed as income.) It was seen that gains from stock options constituted nearly a third of the US executives' total remuneration.

The loss of tax revenues from the introduction of stock options would probably be negligible even if they produced no effect whatever in improving the level of corporate efficiency. For the stock options, in these circumstances, would simply constitute transfer of wealth from shareholders to executives (in effect shareholders would be surrendering part of their holding in the company at a price less than that obtainable in the market). At worst it must simply represent a transfer of wealth from shareholders to executives. To this extent it might be argued that it constitutes an 'improvement' in the distribution of wealth in the community. The only question for public policy as regards attempting to promote greater corporate efficiency by stock options is whether or not the economic advantages which might arise are sufficient to outweigh the somewhat narrow egalitarian view which objects to any member of the community receiving untaxed remuneration even where this is in no sense at the expense of the Revenue.

In contrast to stock options, reductions in surtax will occasion a loss of tax revenue unless there is an increase in economic efficiency in companies producing higher taxable profits (and other benefits to the community) and gains in tax revenue elsewhere. The main possible source of other compensating gains in tax revenue are through the reduction of emigration. It was argued in a reference given earlier¹ that emigration resulted in the community losing the whole of the net tax revenues which they might have secured from the emigrant had he remained in the country. A subsequent estimate of the total cost of emigration in terms of future tax revenues lost in this way, put the figure at over £400m per annum.² Given that the total revenue from surtax on earned incomes was of the order of £100m in 1964-5, it follows that a 10 per cent reduction in emigration compared with what it otherwise would have been, would save sufficient tax revenues in future to pay for a 40 per cent cut in surtax on earned income.

Hence it would require relatively small combined improvements in

¹ Merrett and Monk, *op. cit.*

² See A. J. Merrett, 'The Real Brain Drain', *Management Today*, November 1967.

corporate efficiency and reduction in emigration to make such a reduction in the rate of surtax on earned incomes self-financing in terms of tax revenues.

It is of some importance to consider such essentially economic problems as executive remuneration and the efficient utilisation of the nation's educated labour force in this realistic context of the circumstances under which a worthwhile improvement might be brought about. Arguments to the effect that changes in this respect (or indeed any other) will or will not lead to the total solution of major economic problems are irrelevant to the essential issue, namely, that there is sufficient evidence to indicate that the changes are worthwhile relative to their cost.

The essential point is that minimal reforms of the type indicated above would create scope within the fiscal system for substantial lightly taxed forms of incentive remuneration and in particular forms of remuneration, such as stock options, which can be sharply differentiated from salary and thus made highly discriminatory and related to standards of management efficiency.

Implications for company and government policy on executive remuneration

A distinctive feature of US compared with UK executive remuneration is the overwhelmingly greater reliance of US companies on bonus and other forms of discriminatory remuneration. Some 67 per cent of US companies (companies accounting for the bulk of executive employment in the United States) had stock option plans, and these accounted for a substantial proportion of executive remuneration. As was seen in Chapter 4 relatively few UK companies appeared to rely substantially on remuneration other than salary.

In recent years there has been some interest in a shift to discriminatory and profit-related forms of executive remuneration and away from the highly codified and rigid systems of remuneration which have hitherto been common practice in major companies. It is of great importance to corporate efficiency that this trend is encouraged and facilitated by appropriate tax reform of the type referred to above.

The variability of managerial abilities and the variability of conditions and risks in management employment (for example, the differences in demands made upon executives and the risks to which executives are exposed in declining and ailing companies) must be expected to necessitate *efficient* executive remuneration being highly discriminatory

and geared to special abilities and conditions. Willingness to apply and accept such discrimination in salary is doubtless influenced by the conventional policies pursued elsewhere in the economy (in particular the public sector) and the fact that such additions to remuneration were subject to high marginal rates of taxation. In addition there is the circular problem that executives are unlikely to accept the standards of management discipline implied by highly discriminatory remuneration if levels of *net-of-tax* remuneration are insufficient to bring about the acceptance of such forms of remuneration.

Given a more permissive tax environment, substantial exploitation of the scope which this would open up for greater corporate efficiency would not be brought about by extensive use of discriminatory remuneration policies. Emulation of US practice in this respect might be particularly well founded given that it has evolved in a more permissive tax environment, over a very long period and in response to continental scale competitive conditions.

The major employer of executive talent in the UK is the government which, through its provision of public services and ownership of the nationalised industries, is in effect a massive holding company. As so dominant an employer, a substantial proportion of the scope for higher management efficiency which might be created by a more permissive tax environment must rest with the government.

It is, for example, open to the government to impose higher standards of management efficiency throughout the nationalised industries and Civil Service with increased but highly discriminatory salaries, the abolition of any formal security of tenure at all higher levels of salary and the provision (and utilisation) of generous severance of terms.

It would seem likely, given modification of the structure of taxation as proposed above, that in the private sector the majority of companies would be anxious to exploit the potentiality for higher management efficiency offered by this more permissive tax environment. As the public sector has a dominant role in setting conditions of employment, positive initiative by the public sector and reliance on emulation rather than exhortation might be expected to accelerate and further develop such improvements in the standards of management efficiency throughout the UK economy.

Conclusions

In the exploration of the relationships between efficient utilisation of the educated labour force, executive remuneration and corporate

efficiency, the assumption throughout has been that the community would be prepared to countenance possibly substantial differentials in the net remuneration and conditions of employment of the relatively large proportion of the educated labour force accounted for by the profession of management. But the magnitude of the financial discrimination, the more exacting and discriminatory demands on executives, and the cultural changes which all this may imply in terms of the relative status and influence of the business community and possibly the increased competitiveness of professional life, may be thought too high a price to pay for the resulting economic advantages. An important consideration is the likelihood that the principal beneficiaries of a higher level of efficiency in the private and public sectors would be the community at large while the net benefits to the more highly remunerated sections of the educated labour force might be significantly offset by these adverse changes in their working environment.

Against this it can be argued that the opportunities from higher financial remuneration for a richer more varied cultural life and security offered by such remuneration would wholly or largely offset the disadvantages (if disadvantages they are) of a more demanding and competitive working environment.

The political difficulties of the policies suggested above are also not to be minimised, particularly since these difficulties would be immediate while the benefits might be longer term. For the essential feature of these policies is that the community and the government should, by taxation and conditions of employment, seek to strike a much more demanding productivity bargain with the critical sector of the labour market—the educated labour force.

Appendix A

Questionnaire

Size of Company (Issued Capital + Reserves + Debentures)		£
Position of Director :		
Age :	Proprietorial Interest (greater than 5 per cent)	Yes/No
1. Does this company run any bonus scheme or share option scheme in which you participate ?		Yes/No
2. Do all the directors participate ?		Yes/No
3. Do all of the executives participate ?		Yes/No
4. Is there a memo on the scheme which we could look at ?		Memo Yes/No See it Yes/No
4a. Could you then give us the essential details of the scheme ?		
5. Are you allowed to take on outside directorships ?		Yes/No
6. Has the opportunity arisen for additional income by taking on extra work ?		Yes/No
7. Did you take the opportunity ?		Yes/No
8. Why not ?		
8a. What sort of work was it ?		
How many hours per month did this involve ?		
What fees were paid for this work ?		
9. Did you have any other opportunities apart from this one ?		Yes/No
10. Why was this not taken ?		

11. Of course, we all have to make a decision about the amount of time we spend at work and the amount we can call our own time. One of the factors affecting this decision is obviously the financial reward obtained from our job.
If in fact your company could offer you a 10 per cent increase in your *take-home* pay in return for increasing the numbers of hours you work by 10 per cent, would you agree?

12. What is the minimum increase in take-home pay that you would need to compensate you for 10 per cent more hours of work?

13. If they offered you the 10 per cent increase in take-home pay in return for adding this sum in £. say £ to the company's profits
Could you do it?¹

Would you do it?

14. Do you regard your company as a favourable performer profit-wise compared to your industry as a whole?

Yes/No

15. What is your company's before-tax return on capital employed?

16. How does this compare with other companies in your industry?

17. Can you see your company (continuing) (beginning) to perform relatively better than the industry?

Yes/No

18. Can you see your company (continuing) (beginning) to perform relatively better than companies generally?

Yes/No

- 18a. One way of achieving an improvement in performance would be to get each director and executive to secure an increase in profit or a cut in costs. Suppose you and the other responsible directors were granted the power to hand out a tax-free sum of money equal to 10 per cent of your executive and directorial payroll to the directors and executives, earning more than

¹ If no, ask if he could not cut down on the cost of the car he drives or effect other simple economies.

£5,000 p.a. Do you think this would enable you to obtain an improvement in general efficiency and profitability that would enable the company to recoup this 10 per cent addition to its serving executive payroll costs ?

Yes/No

19. If you were offered a job involving say two days per month, repeat two days per month, as a part-time director of a similar company to this one, quite close to here, but of course in a different industry, would you take it ?

Yes/No/Depends
on money

20. What fees would you require ?

21. This sum is presumably gross of tax ?

Yes/No

22. This would leave only £ net of tax.

23. What after-tax figure would you require for the two days work ?

24. If the job involved a total of 5 hours travelling for each day what additional after-tax sum would you require compared with the sum referred to earlier ?

(If respondent too old, ask same questions but ten years ago.)

Now, if we may, we would like to discuss your attitude to saving. In this context we mean anything which increases your net wealth—for example, paying off part of a mortgage, endowment policy premiums and obviously all forms of investment.

25. Do you regard yourself as having saved over the year ?

26. Do you have any deliberate policy for saving ?

27. Roughly what percentage of your present income do you save ?

28. If you received £1,000 of additional emoluments p.a. *net-of-tax* what proportion of this do you think you would save ?

29. Have you spent any of the capital gains you realised ? (Check through column on wealth page.)

30. How much ?

74 Executive remuneration in the UK

31. Do you regard yourself as better off? (than a year ago)
32. Have you built up your present wealth from saving, capital gains or from inheritance? Saving/Gains/
Inheritance
33. What proportions?
34. What sums have you inherited and when? (itemise)
35. What do you think of deferred annuities and other insurance policies as a way of saving money?
36. One of the difficulties in discussing the effects of taxation upon a person's incentive to work is to be clear about the alternatives on the tax change, for example, what tax alternatives are in mind, how exactly they would affect *your* net of tax income. Suppose we were thinking of a 20 per cent cut across the board in your tax bill on earned income. On the basis of the information that you have already supplied this would imply an increase of about £ in your take-home pay.
One possible effect on you would be that you worked harder because promotion, salary increases and bonus payments would all be worth more, since your marginal rate had been cut. Alternatively, looking at the increase in the take-home pay which the tax cut had given as a free benefit you could be inclined to work less since the government had already increased your net income. Would you think carefully about your reaction to this new situation (repeat) and consider whether on balance you would work harder, longer or more effectively. If yes, would your extra effort, in your opinion, be sufficient to increase the profits of the company by £ ?
37. Could you briefly describe your working day yesterday?
38. Did you work *last* Saturday? Yes/No
How long?
Did you work *last* Sunday? Yes/No
How long?

39. What length holiday are you entitled to ?
40. How long did you take last summer ?
41. Do you work harder now than twelve months ago ? Yes/No
42. For what reason ? (either way)
43. (For non-proprietary directors only.)
Would you work harder if you had a fair-sized holding in the company ? Yes/No
44. (Prove or reason.)
Simply because own company ?
Capital gains taxed less.
45. An individual earning say £8,000 (£5,000, £3,000) is paying tax at the marginal rate of about 60 per cent (45 per cent, 33 per cent). Do you think this is an important factor in the way that you are able to attract an executive to work for you ? Yes/No
46. I suppose the essential problem is that to leave the executive better off by say £500 p.a., you would have to offer an extra £1,400 (£900, £750), have you had an experience of this point being made to you ?
47. Of course, it is possible to devise systems of executive remuneration which are more lightly taxed than a straightforward salary offer. Do you have a policy with respect to these type of payments ? Yes/No

Appendix B

Notes and Statistics

This appendix reproduces in graphical or tabular forms the majority of the data obtained by the survey. In the main text we have used only the data directly relevant to our particular enquiry. The total data may have wider interest and it is presented here without comment, to be used by commentators on other enquiries.

In the case of bar charts, the vertical axis is the number of directors within the classification noted on the horizontal axis.

Definitions are as follows:

Figure A.1

Total income is defined as net of allowable expenses but gross of all personal allowances and taxes. It includes all sources of income, for example, salary, bonuses, professional income, dividends, property income, etc., and includes wife's income, if any. The total income ranges are those available for marking on the questionnaire.

Figure A.4

The directors were asked to indicate within which range what percentage of total income was regarded as 'earned' for income tax purposes.

Figure A.8

With knowledge of total income and percentage 'earned' it is possible to estimate a figure the director will be paying in income tax and surtax. The 'percentage paid in tax' is thus this estimate as a percentage of total income. Note that our estimate may represent the maximum for any particular director since in reality allowances for insurance premiums, interest relief, etc., will be claimed in addition to our assumption of a married director with two children although given the age of the directors our assumption that they are entitled to children's allowances probably largely counterbalances this.

Figure A.10

With knowledge of total income it is possible to calculate a marginal rate of taxation. The 'percentage paid in tax' is the extra tax due on additional

income which is classified as 'earned', as a percentage of the additional income of £1,000 p.a.

Figure A.13

Net wealth is property (home, other houses, land, etc.) plus quoted shares at market value plus unquoted shares at a market value or net asset value plus fixed interest stocks, loans, building society deposits, cash, etc., plus sums assured on endowment policies less mortgages and bank loans outstanding.

Figure A.17

The maximum disposable wealth is defined as net wealth (see Figure A.13) less the value of the director's home and sums assured on endowment policies.

Figure A.21

Each director was asked to detail the hours he had worked the previous day (or previous Friday). The hours shown include lunch in every case whether a working lunch or not, all tea breaks, etc., and evening work at home. Three answers were not recorded and two directors were currently in semi-retirement. In the main text the figures are supported by those from Rosemary Stewart's study. Her figures were collected on a more detailed and rigorous basis but there is a relationship between her results and ours.

Figure A.24

The weeks of holiday include both summer and winter holidays and broadly cover July 1966 to July 1967. Answers for three were not recorded and one was in semi-retirement for the whole of the period.

Table A.4

Each director was asked to try to split his current net wealth into inherited sums, that obtained by saving out of net-of-tax income and that obtained through capital gains. Necessarily with a problem as complex as this the answers are approximations.

Table A.1

Cross-classification of category and company type

	Quoted company	Unquoted company	
<i>Salaried and professional</i>	15	17	32
<i>Self-made</i>	6	7	13
<i>Inherited</i>	3	3	6
	—	—	—
	24	27	51

Table A.2

Calculations of average values by category

	All directors	Salaried and professional	Self-made	Inherited
<i>Total income (£'000)</i>	10-15	10-15	20-30	15-20
<i>Average rate of tax</i>	47.3%	40.9%	59.6%	55.3%
<i>Marginal rate of tax</i>	64.9%	59.7%	75.7%	68.6%
<i>Net wealth £'000</i>	*	25-50	*	*
<i>Disposable wealth £'000</i>	*	15-20	*	*
<i>Average saving (out of total income)</i>	10%	10%	5%	0%
<i>Marginal propensity to save</i>	75%	75%	90%	90%
<i>Hours worked (per day)</i>	9	10	9	3
<i>Holidays (weeks per year)</i>	3	3	4	4
<i>Age:</i>				
<i>Mean</i>	51	49	60	44

* Mean calculation not possible due to readings in one open-ended classification.

Table A.3

Calculations of average values by company type

	Quoted	Unquoted
<i>Earned income, £'000 (unweighted)</i>	10-15	5-10
<i>Earned income, £'000 (weighted by number of companies of the type in total population)</i>	10-15	5-10
<i>Average rate of tax (unweighted)</i>	53.7%	41.7%
<i>Average rate of tax (weighted)</i>	48.3%	42.0%
<i>Marginal rate of tax (unweighted)</i>	73.4%	54.3%
<i>Marginal rate of tax (weighted)</i>	68.7%	60.8%
<i>Net wealth, £'000</i>	*	*
<i>Disposable wealth £'000</i>	*	*
<i>Average saving (out of total income)</i>	10%	10%
<i>Marginal propensity to save</i>	75%	75%
<i>Hours worked (per day)</i>	9	9
<i>Holidays (weeks per year)</i>	3	3
<i>Age</i>	54	49

* Mean calculation not possible due to readings in one open-ended classification.

Table A.4

Sources of wealth (where determinable) per cent

	Saving	Gains	Inheritance
<i>Inherited</i>	10	10	80
	0	50	50
	0	20	80
	0	50	50
	35	25	40
<i>Self-made</i>	50	50	0
			0
			0
			0
	25	75	0
	66	33	0
<i>Salaried and professional</i>	100	0	0
			5
	90	10	0
	43	52	5
	55	45	0
	33	0	66
			10
	33	33	34
			0
	100	0	0
	75	25	0
			0
			66
			0
	30	70	0
			0
			0
			0
	100	0	0
			0
	100	0	0
	100	0	0
	12	13	75
	20		
	15	85	0
			30
	0	66	33

Table A.5

Miscellaneous data

(a)	Part of total income dependent upon personal, divisional or company performance	
	Yes	No
<i>All</i>	24	27
<i>Salaried and professional</i>	18	14
<i>Self-made</i>	4	9
<i>Inherited</i>	2	4

(b)	Salaried and professional Self-made Inherited			
Type of bonus scheme	All			
<i>Traditional (tends not to vary)</i>	3	3		
<i>Flat rate on salary</i>	1	1 (12½%)		
<i>Geared to profit or net profit</i>	10	8 (6%, 1%, 3½%, 67%)	1	1
<i>Points system</i>	1	1 (7½%)		
<i>Share option</i>	1	1		
<i>Capital employed</i>	1		1	
<i>Profit and loss account</i>	3	2		1 (25%)
<i>Turnover</i>	1		1	
<i>Other</i>	3	2 (25%, 20%)	1	
	—			
	24			

Note. Figures in brackets are the proportion of total income dependent upon scheme, where known.

(c)	Hours worked 'yesterday'	<8	8	9	10	>10
	Average age	45½	60	55½	46½	46

Table A.6

Forms of wealth (%)

	Property, land	Quoted shares	Unquoted shares	Fixed interest, cash	Sums assured	Mort- gages, loans
<i>Inherited</i>	13	50	1	36	0	0
	38	11	*	21	30	0
	19	*	0	40	41	0
	30	6	*	60	4	0
	72	1	43	1	5	-22
	38	6	18	38	0	0
<i>Unweighted mean‡</i>	—	—	—	—	—	—
	41	19	21	25	2	-7
	—	—	—	—	—	—
<i>Self-made</i>	33	46	0	4	17	0
	61	11	0	4	27	-3
	26	43	0	0	43	-12
	19	32	43	4	2	0
	3	44	22	0	31	0
	8	†	91	†	†	0
	18	29	41	10	2	0
	50	50	*	0	0	0
	100	*	0	0	0	0
	45	45	4	0	6	0
	8	70	0	22	0	0
	22	77	†	6	0	-5
	0	†	84	4	12	0
<i>Unweighted mean‡</i>	—	—	—	—	—	—
	22	36	26	5	13	-2
	—	—	—	—	—	—
<i>Salaried and professional</i>	100	0	0	0	0	0
	67	2	2	4	37	-12
	60	0	22	7	60	-49
	12	12	54	9	13	0
	27	1	46	17	9	0
	31	0	67	0	17	-15
	28	0	100	0	0	-28
	48	4	0	4	67	-23
	7	36	36	5	22	-6
	0	32	0	68	0	0
	89	11	4	32	0	-36
	63	49	0	0	13	-25
	278	11	0	11	0	-200
	69	19	0	14	25	-27
	10	18	64	1	7	0

	Property, land	Quoted shares	Unquoted shares	Fixed interest, cash	Sums assured	Mort- gages, loans
	33	33	0	34	0	0
	22	48	22	0	12	-4
	62	22	0	16	0	0
	21	0	70	4	13	-8
	45	25	0	12	18	0
	91	6	0	0	16	-13
	28	59	10	0	28	-25
	23	16	49	12	0	0
	59	35	2	1	7	-4
	12	59	0	7	22	0
	48	0	67	4	4	-23
	35	8	25	3	49	-20
	58	0	0	5	58	-21
	41	15	8	21	15	0
	15	11	64	4	6	0
	19	69	0	3	9	0
	63	88	0	0	0	-51
<i>Unweighted</i>	—	—	—	—	—	—
<i>mean</i>	49	22	22	9	16	-18
	—	—	—	—	—	—

* This form of wealth represents over £½m. but upper limit not known; percentages are of the forms of wealth *other than* this category for the director.

† Small sums only (less than 1 per cent).

‡ Excludes directors marked *; small errors due to rounding.

Table A.7

*Age and maximum disposable wealth
for salaried and professional directors*

Maximum disposable wealth £'000	Age
-10 to -7.5	39
-5 to -4	45
-4 to -3	37
-3 to -2	48
-2 to -1	47
0 to 1	50
1 to 2	51
3 to 4	37
7.5 to 10	47
10 to 15	50
15 to 20	61
20 to 25	55
25 to 50	51
50 to 75	45
100 to 150	54

Table A.8

Estimate of working week

	Mon.-Fri.	Sat.	Sun.	Total
	hours	hours	hours	hours
<i>All</i>	9 × 5	1½	1¼	47¾
<i>Salaried and professional</i>	10 × 5	1¾	1½	53¼
<i>Self-made</i>	9 × 5	1	1	47
<i>Inherited</i>	3 × 5	1½	½	17

Note. The mean for each category of director and all directors is taken to be the mean also representing the distribution of hours normally worked by one director, by multiplying by 5 a typical working week is thus obtained.

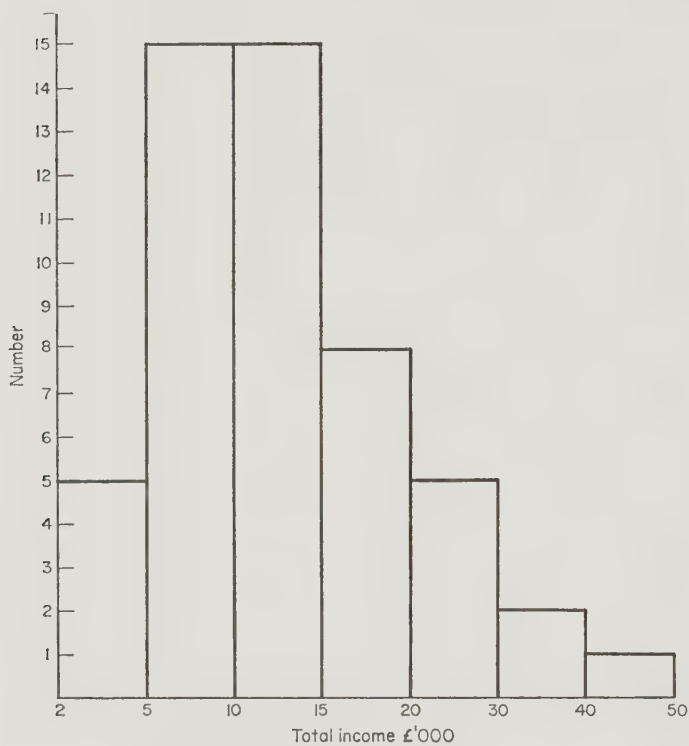


Figure A.1. Total income—all directors

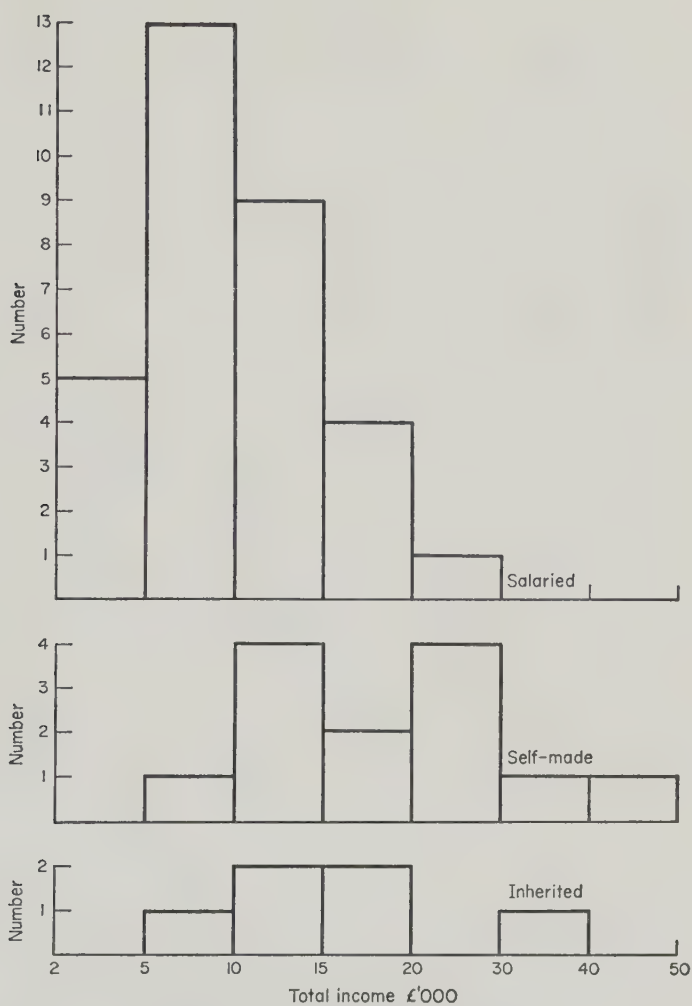


Figure A.2. Total income—by category

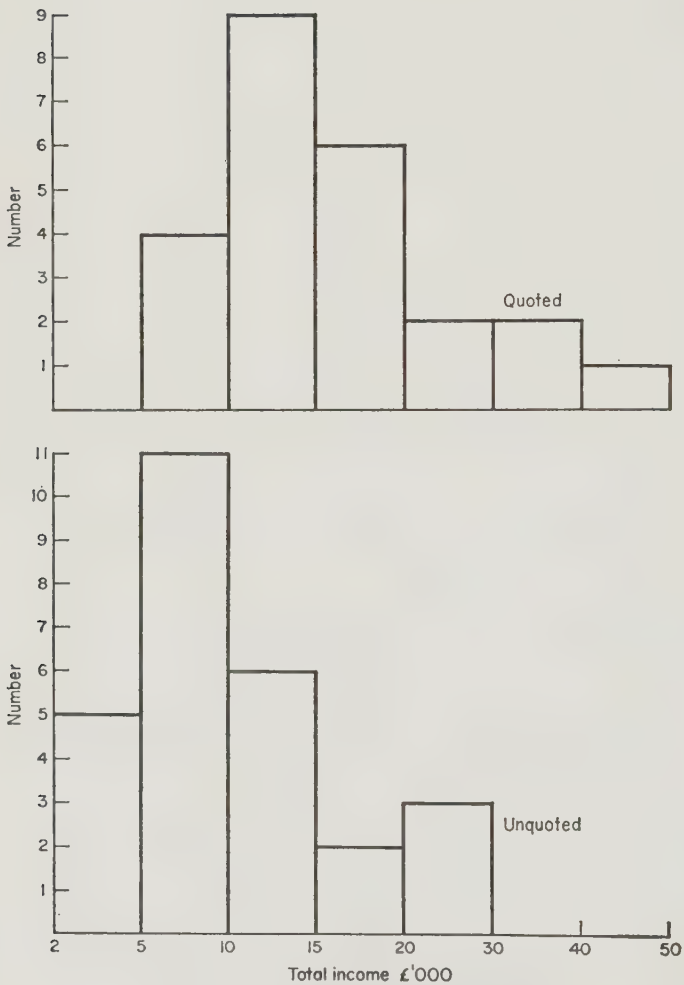


Figure A.3. Total income—by company type

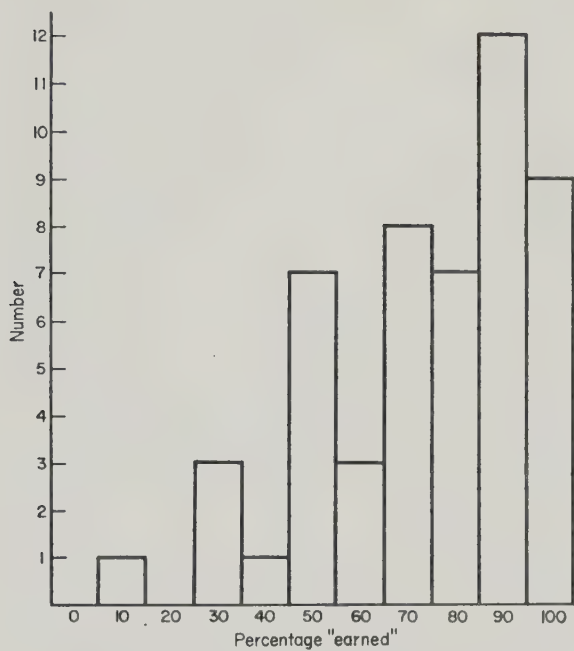


Figure A.4. Percentage of income 'earned'—all directors

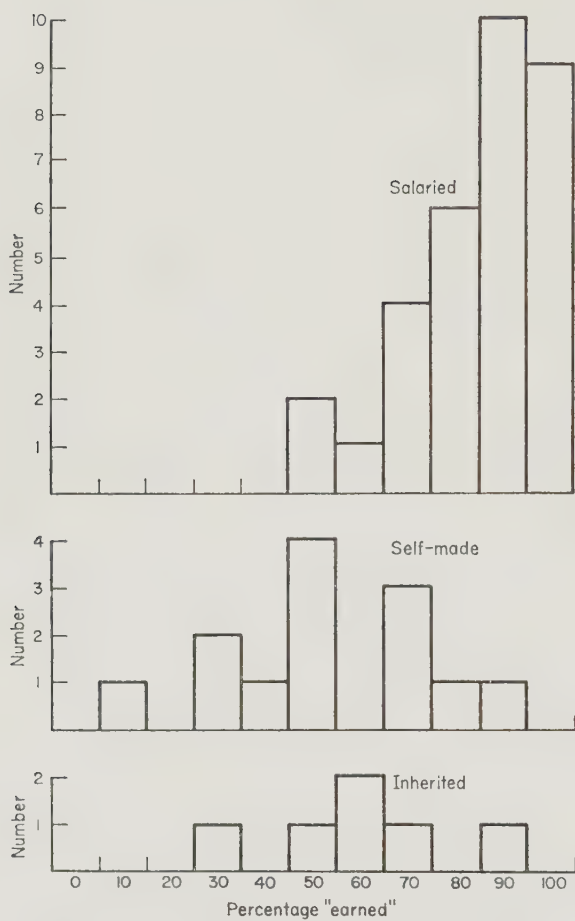


Figure A.5. Percentage of income 'earned'—by category

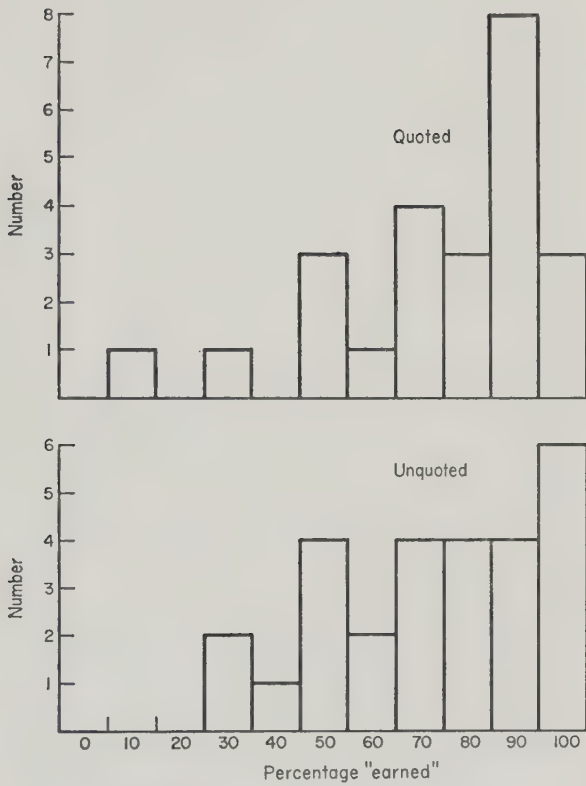


Figure A.6. Percentage of income 'earned'—by company type

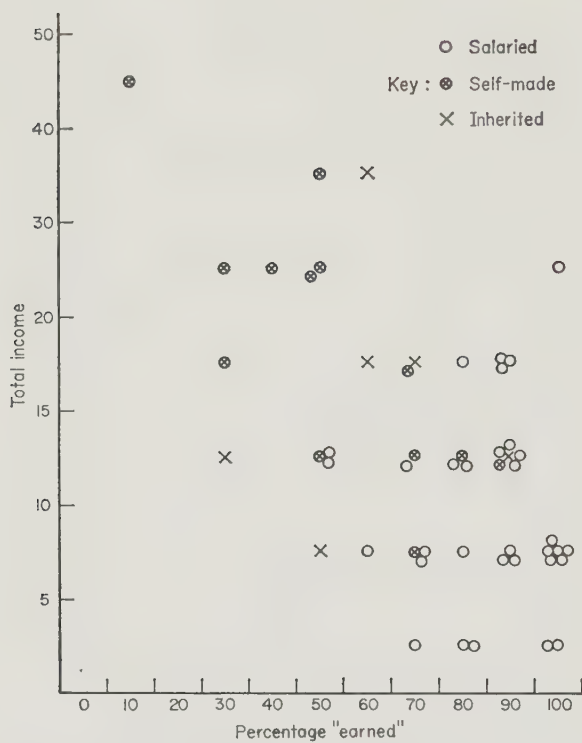


Figure A.7. Relationship of total income to 'earned' income

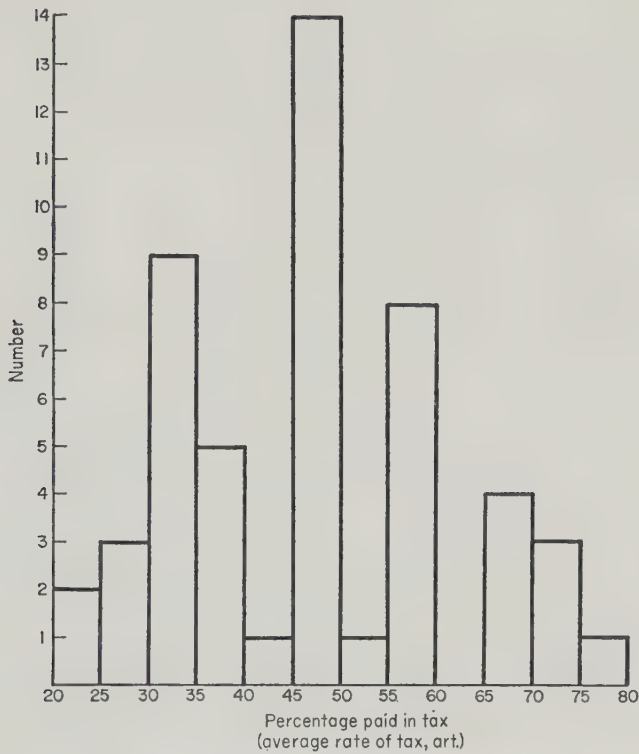


Figure A.8. Percentage of total income paid in tax—all directors

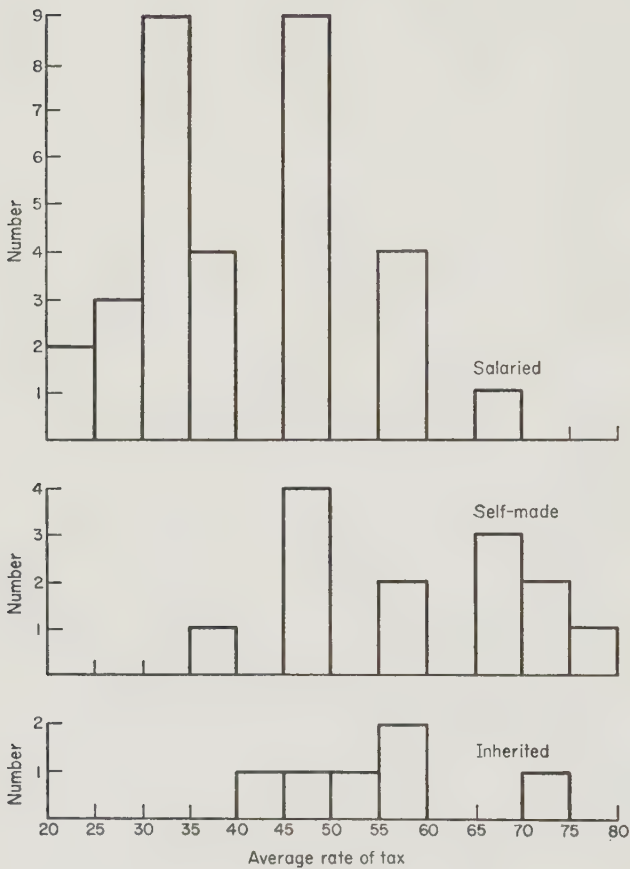


Figure A.9. Average rate of tax—by category

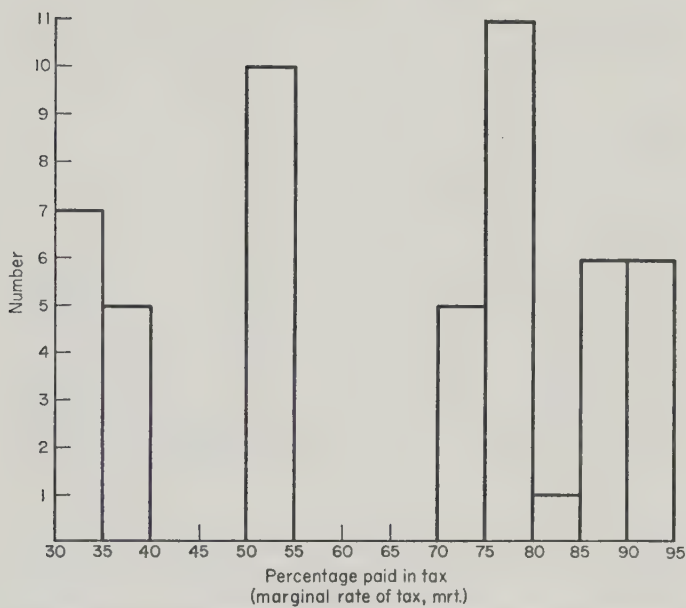


Figure A.10. Percentage of additional income paid in tax—all directors

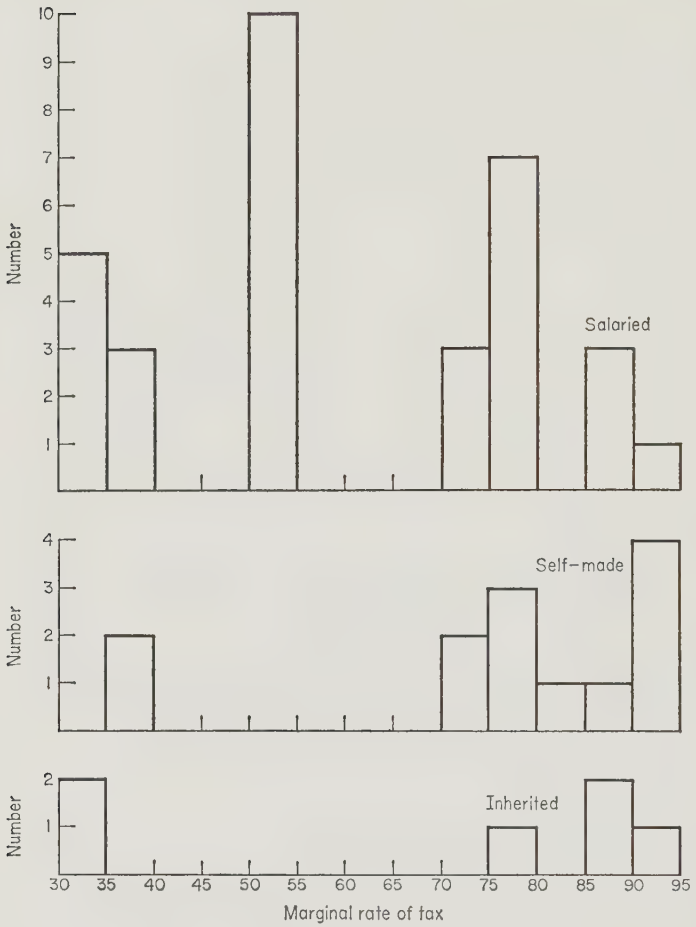


Figure A.11. Marginal rate of tax—by category

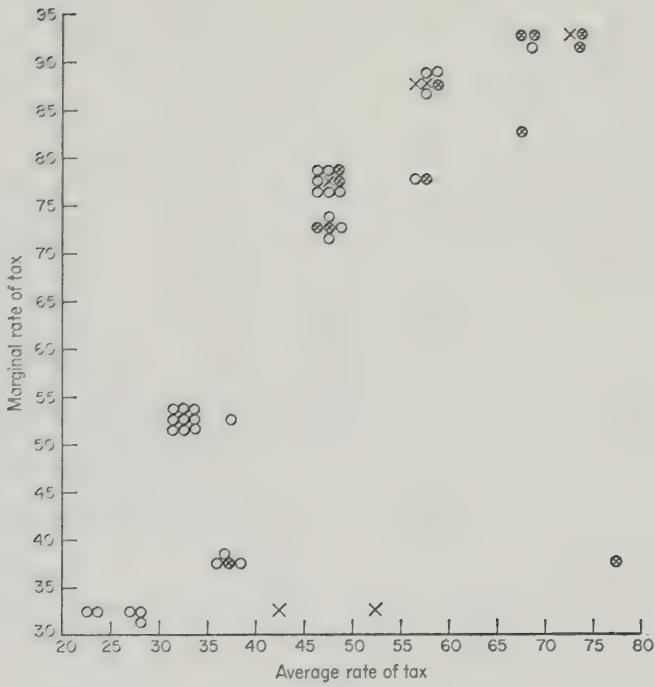


Figure A.12. Relationship of ART to MRT

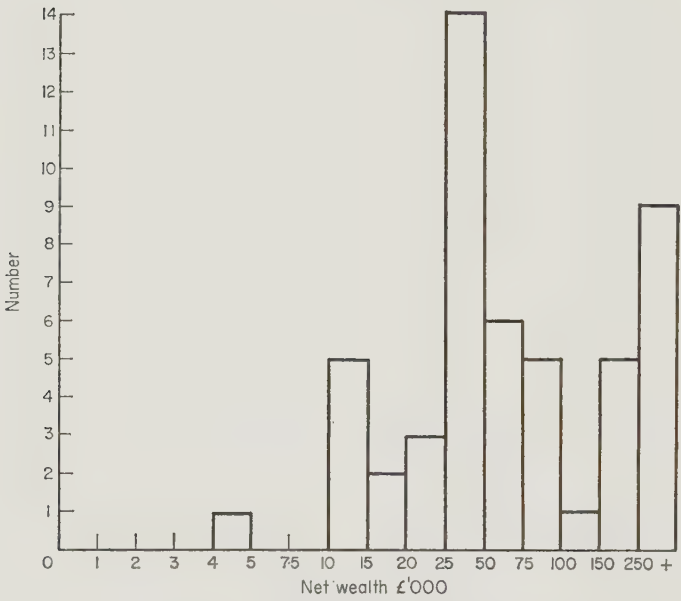


Figure A.13. Net wealth—all directors

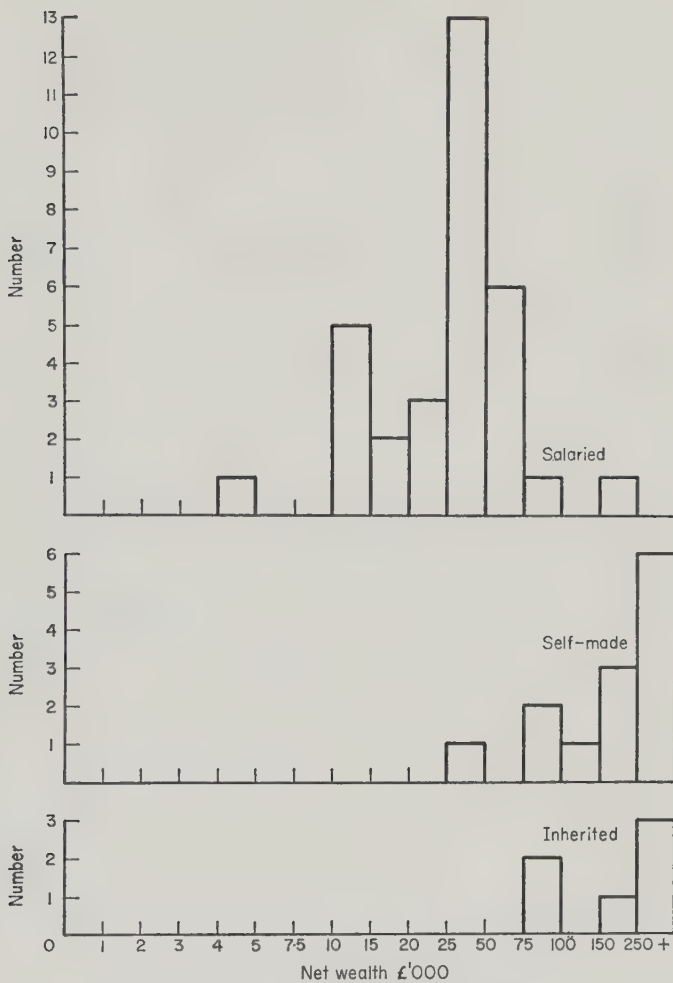


Figure A.14. Net wealth—by category

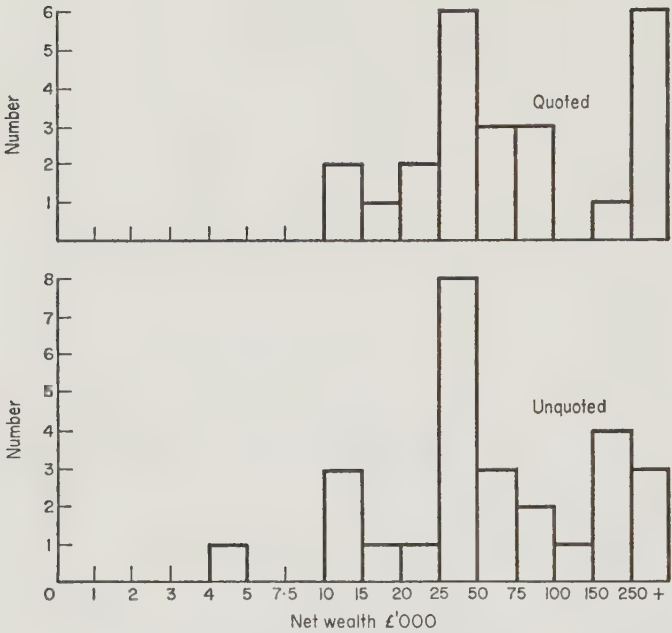


Figure A.15. Net wealth—by company type



Figure A.17. Maximum disposable wealth—salaried directors

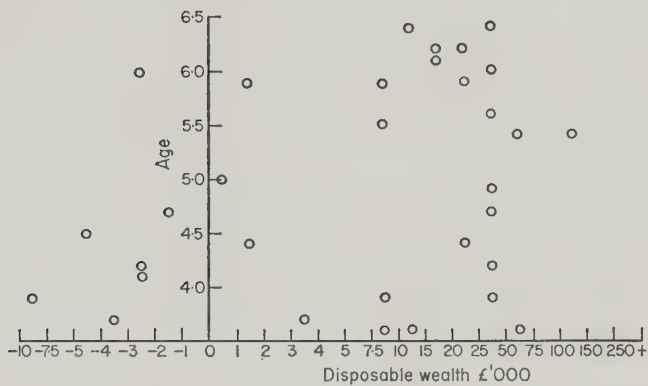


Figure A.18. Relationship of age to disposable wealth—salaried directors

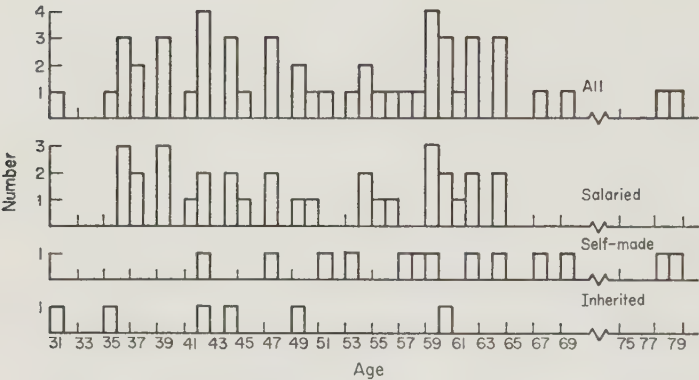


Figure A.19. Age distribution—all directors and by category

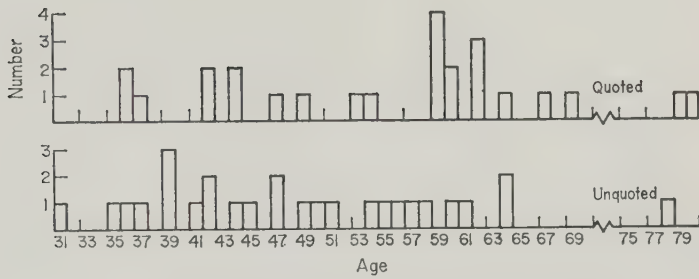


Figure A.20. Age distribution—by company type

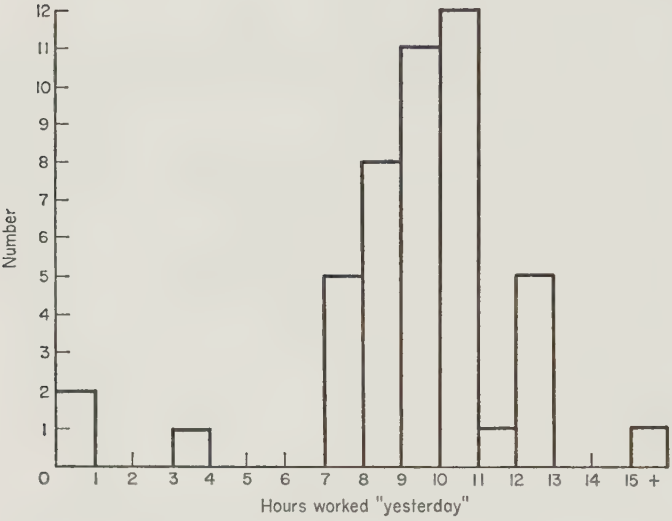


Figure A.21. Number of hours worked 'yesterday'—all directors

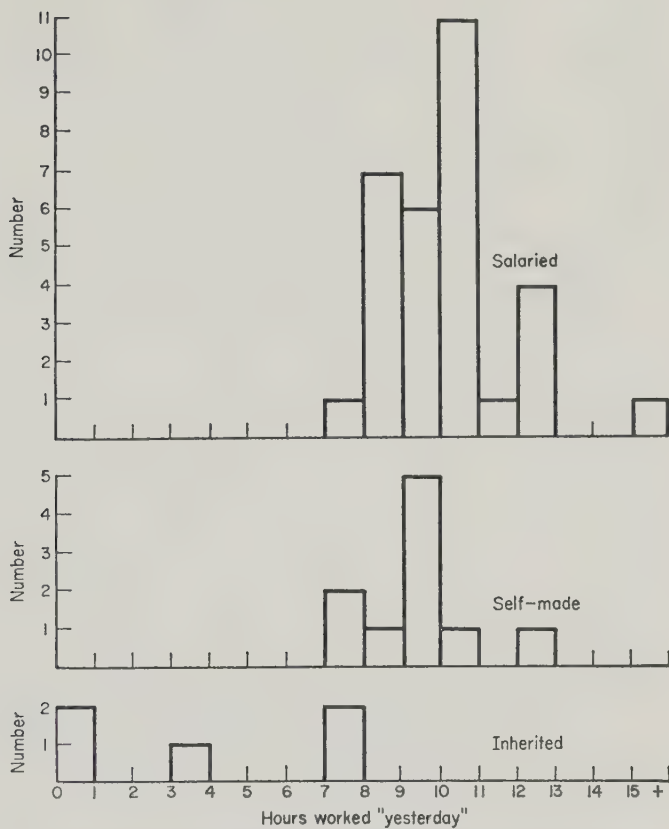


Figure A.22. Number of hours worked 'yesterday'—by category

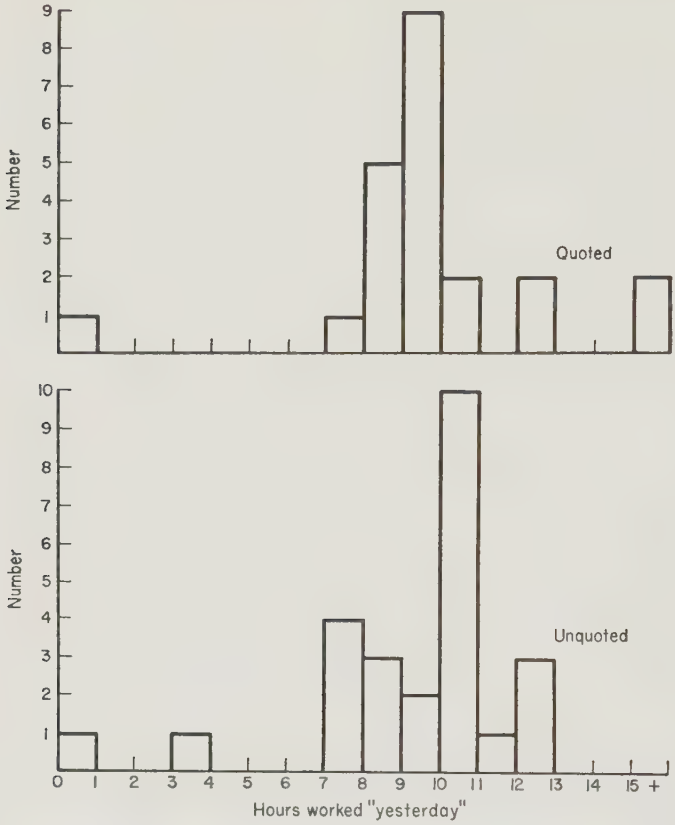


Figure A.23. Number of hours worked 'yesterday'—by company type

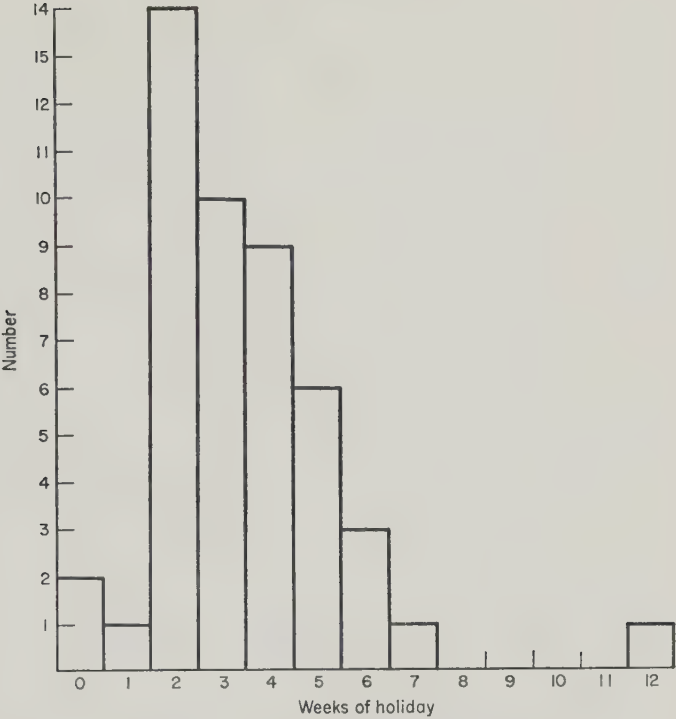


Figure A.24. Weeks of holiday—all directors



Figure A.25. Weeks of holiday—by category

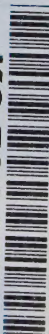
Executive Remuneration in the United Kingdom

A. J. Merrett

Remuneration is a matter of keen interest to any executive. It is also, however, a matter which should be of vital interest to his employer, for the scale of remuneration offered may well determine the strictness of the work criteria which an employer can impose on his executives and which may be necessary to ensure corporate efficiency in any industry or business.

In the course of compiling this book the author undertook an extensive survey of the remuneration of directors and of their views on the relationship between remuneration and corporate efficiency. In this book he discusses that relationship and compares the relative efficiency of UK and US executives and their relative remuneration.

KQ-784-067



21s net